

Getting Loan Mods for Successors in Interest



Diane Thompson, Of Counsel, National Consumer Law Center

Jessica Hiemenz & Beverlie Sopiop
National Consumer Law Center

May 22, 2014



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Presenter – Diane E. Thompson

- Has represented low-income homeowners since 1994.
- She is currently of counsel with the National Consumer Law Center, where she is the co-author of the NCLC treatise Truth in Lending and a contributing author to Cost of Credit.
- Among other publications, she wrote *Foreclosing Modifications*, 86 Wash. L. Rev. 755 (2011), and co-authored with Elizabeth Renuart *The Truth, the Whole Truth, and Nothing But the Truth: Fulfilling the Promise of Truth In Lending*, 25 Yale J. Reg. 181 (2008).
- From 1994 to 2007, Ms. Thompson represented individual low-income homeowners in East St. Louis at Land of Lincoln Legal Assistance Foundation. While there, Ms. Thompson served as the Homeownership Specialist, providing assistance to casehandlers representing homeowners in 65 counties in downstate Illinois, and the Supervising Attorney of the Housing and Consumer unit of the East St. Louis office.





Getting a Loan Mod for Successors-in-Interest

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Diane E. Thompson, NCLC

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Poll #1: Experience

- Have you gotten a loan mod for a successor-in-interest (surviving relative, child, ex-spouse)?
 - A. Never
 - B. Once
 - C. Two to 5 times
 - D. More than 5 times



Questions?

- Comments on your experience in getting (or trying to get) a loan mod for successors-in-interest?



Definitions

- Successors-in-interest
 - Homeowners who get property from a family member & are protected by Garn-St Germain Act
 - CFPB uses primarily for transfers resulting from death
- Assumption
 - Acceptance of legal liability for payment of note
- Due-on-sale clause
 - Provision in mortgage permitting acceleration of mortgage upon transfer of property



How Your Client Got Here

- Land transfers independently of mortgage
- Mortgagee can't stop transfer of land
- But land remains subject to mortgage

- Black letter law
- *See, e.g.*, Lawrence R. Ahern, 1 The Law of Debtors and Creditors §8:10 (2013) (mortgagors may transfer their property interest); 55 Am. Jur. 2d Mortgages § 1018.



What Happens to the Mortgage?

- Stays in place
- Existing homeowner has continuing obligation to pay, unless mortgagee releases
- Old homeowner and new homeowner can agree between them that new homeowner will make payments
 - This is an assumption
 - Mortgagee can't dictate terms of this agreement
 - *Olson v. Etheride*, 686 N.E.2d 563 (Ill. 1997)



Poll #2: Stumbling Blocks

- What do your clients want?
 - A. A loan mod
 - B. Payments accepted
 - C. Information about the account
 - D. Correspondence, including 1099's, in their names
 - E. Other?



Assumption May Be Key to Getting Mod

- *In re Mitchell*, 184 B.R. 757 (Bankr. C.D. Ill. 1994) (finding no creditor-debtor relationship where parents transferred property to son and no equitable grounds for imposing one where son did not assume mortgage)
- *Brush v. Wells Fargo Bank, N.A.*, 911 F.Supp.2d 445 (S.D. Tex. 2013) (finding that daughter, who inherited family home, was entitled to all the rights of a borrower under the mortgage contract upon assumption of the mortgage)



Warning: Assumptions Are Dangerous

- Without an assumption, the homeowner has no personal liability on debt
- Mortgage may still be modifiable in a bankruptcy without assumption
- Simultaneous evaluation for loan modification and processing of assumption is critical
 - CFPB Bulletin 2013-12 (Oct. 15, 2013)



Right to Assume the Mortgage

- General rule that contracts are freely assignable
- Mortgage contracts recognize this
 - *See, e.g., Andrews v. Holloway*, 231 S.E.2d 548, 549 (Ga. Ct. App. 1976) (holding that lender's consent to assumption was not required where mortgage contract provided it was binding on the borrower's "assigns").



Due-on-Sale Clause

- If mortgagee doesn't like land transfer can accelerate mortgage and demand payment in full
 - If there is a valid due-on-sale clause
- Exercise of due-on-sale clause contract right
 - What is the language? Reasonable?
- Lender can be equitably estopped from exercising due-on-sale clause
 - *See, e.g., In re Nunnery*, 2011 WL 4712083 (Bankr. M.D.N.C., Aug.17, 2011)(allowing debtor to pay off manufactured home loan in chapter 13, even though debtor lacked privity with mortgagee; finding assignee of mortgagee equitably estopped from denying debtor's ownership interest where it had accepted payments from her for seven years)



Pre-Garn Courts Generally Recognized Right to Assume Absent a Due-on-Sale Clause

- *Coffing v. Taylor*, 16 Ill. 457 (1855);
- *See, e.g.* *Solomon v. Copping*, 112 So. 2d 749, 751 (La. Ct. App. 1959) (“[I]t is well settled that, where there is in an act of mortgage no statement to the effect that it cannot be assumed without the written consent of the mortgagee, the transfer of property may be made and the mortgage may be assumed”); *L. Klein, Inc. v. Escarra*, 122 So. 880 (La. App. 1929) (finding mortgagee powerless to prevent assumption of mortgage); *Bermes v. Sylling*, 587 P.2d 377, 384 (Mont., 1978) (“The agreement between the parties contained no prohibition on assignment or transfer of the mortgaged lands. Sylling as mortgagee, therefore, could neither disapprove nor interfere with Bermes' attempt as mortgagor to trade the Barber Ranch to Harris subject to the mortgage.”); *Young v. Hawks*, 624 P.2d 235, 237 (Wyo., 1981). *Cf.* *Federal Nat'l Mortgage Ass'n v. C.I.R.*, 90 T.C. 405, 415 n.13 (Tax Court 1988) (“Prior to 1972, conventional mortgages frequently contained no ‘due-on-sale’ clauses, and were freely assumable”), *aff'd*, 896 F.2d 580 (D.C. Cir. 1990).



Questions about Assumptions?



Getting the Loan Mod

- Garn-St. Germain Depository Institutions Act at 12 U.S.C. § 1701j-3 *et seq* (1982) revisited
- Bankruptcy
- Assumption & mod



Garn: Why It Matters

- If due-on-sale clause not enforceable, then homeowner has right to assume the mortgage
- Gives bankruptcy courts comfort that the transfer is legitimate



Garn: Legislative History

Purpose

- Protect lenders from assumptions of low-rate mortgages in high-rate environment by allowing enforcement of due-on-sale clauses
- “For lenders, due-on-sale restrictions further extend the lives of older low interest mortgages, and prevent lenders from increasing the yields on those loans at the time the property is transferred.”
- S. Rep. No. 97-536, at 20-21 (1982), *reprinted in* 1982 U.S.C.C.A.N. 3054, 3075



Garn Exceptions

- 12 U.S.C. §1701j-3(d)
 - (d)(3) Transfer on death to joint tenant or tenant by entirety
 - (d)(5) Transfer on death to a relative
 - (d)(6) Transfer to a spouse or child(ren)
 - (d)(7) Transfer as part of a legal separation or divorce



Why These Exceptions?

- Because not allowing assumption in these circumstances would be “inequitable”
- “[I]t would be unfair and inappropriate for lenders to enforce due-on-sale clauses” under those circumstances.”
- S. Rep. No. 97-536, at 24 (1982),
reprinted in 1982 U.S.C.C.A.N. 3054,
3078



What About Creditworthiness?

- First, note that the usual reason given for due-on-sale clauses is creditworthiness
 - *See, e.g., In re Allen*, 300 B.R. 105, 119 (Bankr.D.D.C.2003)
- *Compare* 12 U.S.C. § 1701j-3(c)(2)(A) (providing that lenders may refuse to honor assumptions for transferee homeowners who do not meet “customary credit” standards, even if the due-on-sale clause would be otherwise unenforceable) *with* 12 U.S.C. § 1701j-3(d) (flatly prohibiting the exercise of due-on-sale clauses)
- *Compare* 12 C.F.R. § 191.5(b)(3) (forbidding lenders from collecting prepayment penalties if they enforce due-on-sale clause when presented with creditworthy transferee) *with* 12 C.F.R. § 191.5(c) (providing that restriction on enforcement of due-on-sale clauses is only subject to continuation of mortgage insurance)



If a Garn Exception Applies, the Due-on-Sale Clause May Not Be Invoked

- 12 U.S.C. §1701j-3(d).
- *French v. BMO Harris Bank, N.A.*, 2012 WL 1533310, at *3-*4 (N.D. Ill. Apr. 30, 2012) (finding that successor homeowner protected by Garn has a “federal right;” remanding to bankruptcy court to determine if indeed successor homeowner, purported nephew of original borrower, is protected under Garn-St Germain Act)
- *Brush v. Wells Fargo Bank, N.A.*, 911 F.Supp.2d 445, 460 (S.D. Tex. 2013) (mortgagee may not enforce due-on-sale clause based on inheritance of family home by daughter); *In re Smith*, 469 B.R. 198, 202 (Bankr. S.D..N.Y.,2012) (finding lender may not exercise due-on-sale clause upon transfer from mother, now deceased, to daughter); *In re Cady*, 440 B.R. 16, 20 n. 9 (Bankr. N.D. N.Y. 2010) (mortgagee may not enforce due-on-sale clause in mortgage pre-dating enactment of Garn based on transfer from parents to son and his wife); *In re Alexander*, 2007 WL 2296741 (Bankr. N.D. Fla. 2007) (mortgagee may not enforce due-on-sale clause based on transfer on death); *Citicorp Mortg. v. Lumpkin*, 144 B.R. 240, 241 (Bankr. D. Conn. 1992) (mortgagee may not enforce due on sale clause based on transfer from mother to daughter)



What Happens without an Enforceable Due-on-Sale Clause?

- Mortgage cannot be accelerated
- Borrower may transfer her rights under the mortgage contract to another
- Successor-in-interest may assume the mortgage



Questions about Garn?



Bankruptcy as a Forum

- Chapter 13 (or Chapter 12) to bring arrears current
- May include ability to modify loan
 - *In re Smith*
- Two distinct theories:
 - Ownership interest in land means land part of estate, mortgage can be brought in as claim
 - Privity of contract irrelevant
 - No need for assumption
 - Homeowner has assumed the mortgage



Ownership Is Enough

- Johnson v. Home State Bank, 111 S.Ct. 2150 (1991)
- Line of cases finding a mortgage on either real or personal property may be included in the plan if there is an ownership interest, even without privity
- *In re McNeal*, 2011 WL 4381725 (Bankr. M.D.Fla. Sept. 1, 2011)(finding son who inherited a one-tenth interest in the home from his mother and subsequently received quit claim deeds from 4 of 9 co-owners, could include mortgagee's claim in his bankruptcy plan); *In re Nunnery*, 2011 WL 4712083 (Bankr. M.D.N.C., Aug.17, 2011)(allowing debtor to pay off manufactured home loan in chapter 13, even though debtor lacked privity with mortgagee; finding assignee of mortgagee equitably estopped from denying debtor's ownership interest where it had accepted payments from her for seven years); *In re Evans*, 2011 WL 1420887 (Bankr.M.D.N.C. Apr. 11, 2011) (allowing debtor to include reverse mortgage in chapter 13 plan, even though debtors were not in privity with mortgagee); *In re Lozada*, 446 B.R. 604, 606 (Bankr. M.D.Fla. 2011) (allowing claim to be included on basis of quit claim deed from stepsister, not a protected category under Garn-St Germain, while noting that the debtor may have acquired her interest upon her mother's death, which would be a protected category under Garn-St Germain); *In re Trapp*, 260 B.R. 267, 268 (Bankr.S.C.2001).



Some Bankruptcy Courts Rely on Garn

- French v. BMO Harris Bank, N.A., 2012 WL 1533310, at *3-*4 (N.D. Ill. Apr. 30, 2012) (reversing bankruptcy's court's lifting of automatic stay)
- *See also In re Smith*, 469 B.R. 198, 201 (Bankr. S.D.N.Y. 2012); *In re Cady*, 440 B.R. 16, 20 n.9 (Bankr. N.D.N.Y. 2010); *In re Allen*, 300 B.R. 105, 119 (Bankr.D.D.C.2003) (transfer from son to mother not protected under Garn, so mortgage not included as claim in mother's bankruptcy estate); *In re Jordan*, 199 B.R. 68, 70 (Bankr. S.D. Fla. 1996); *In re Lumpkin*, 144 B.R. 240, 241 (Bankr. D. Conn. 1992).



Reliance on Garn in Bankruptcy Probably Not Necessary

- See earlier cases
- Existence of due-on-sale clause does not defeat transfer, just provides mortgagee with remedy
 - See, e.g., *In re Smith*, 469 B.R. 198, 202 (Bankr. S.D..N.Y. 2012) (“The consent of the Creditor was not required for the transfer of Nevilla Challenger's interest in the home to the Debtor, regardless of whether the mother was alive or whether an estate had been created.”); *Bermes v. Sylling*, 587 P.2d 377 (Mont., 1978); *In re Fogarty's Estate*, 300 N.Y.S. 231, 236 (N.Y.Sur. 1937).
 - See, e.g., Lawrence R. Ahern, 1 *The Law of Debtors and Creditors* §8:10 (2013) (mortgagors may transfer their property interest); 55 *Am. Jur. 2d Mortgages* § 1018.



Questions about Bankruptcy?



Outside of Bankruptcy

- Privity is a problem
- Need to assume
 - *Compare* Brush v. Wells Fargo Bank, N.A., 911 F.Supp.2d 445, 460 (S.D. Tex. 2013) *with* Generations Bank v. Sciotti, 982 N.Y.S.2d 721 (N.Y.Sup. 2014) (finding that the Garn protections only apply to the exercise of the acceleration clause and do not extend to grant successor homeowners the right to be evaluated for a loan modification without assumption)



What to Do about Assumption after Default?

- Mortgages typically contain right to reinstate
- CFPB regulations and state law impose duty to evaluate borrower for loan modification
- Once mortgage assumed, successor homeowner must be treated like other borrowers



Cases on Assumption After Default

- *In re Allen*, 300 B.R. 105, 119 (Bankr.D.D.C.2003) (finding that mortgage could not be deaccelerated when acceleration resulted from the lender's exercising its "option" to accelerate the debt if there is a transfer of the property without consent, but noting that the result would have been different if the transfer had been among those protected from the lender's exercise of a due-on-sale clause under the Garn-St Germain Act, in which case the reinstatement clause in the mortgage would still apply)
- *In re Jordan*, 199 B.R. 68 (Bankr. S.D. Fla. 1996) (allowing a son who received a 50% ownership interest in the home from his mother after the loan had gone into default to cure the arrearages via a Chapter 13 bankruptcy).
- *Brush v. Wells Fargo Bank, N.A.*, 911 F.Supp.2d 445, 459-460 (S.D. Tex. 2013) (finding daughter who inherited property assumed mortgage by signing loan modification agreement)



Assumptions Help Mortgagees

- Absent a release, the mortgagee can still sue the original mortgagor; assumption adds another party to go after on the debt
- Restatement 3rd of Property: Mortgages § 5.1
- *Bay v. Williams*, 1 N.E. 340 (Ill. 1884) (granting mortgagee right to sue to collect mortgage debt from grantor even though mortgagee was not a party to the assumption)



Questions??



Communications Guidance

- 12 C.F.R. § 1024.38(b)(1)(vi) (requiring servicers to have policies in place to facilitate communication with successor homeowners upon notification of the borrower's death)
- CFPB Bulletin 2013-12 (Oct. 15, 2013)
- Freddie Mac, Freddie Mac Bulletin 2013-3 (Feb. 15, 2013) (“Servicers must provide loan information to transferees that the Servicer has confirmed have a legal or beneficial interest in the Mortgage as necessary to allow the transferee to continue making Mortgage payments or to process a request by the transferee to assume the Mortgage, if applicable.”).



Bogeyman of Privacy

- Gramm-Leach-Bliley Act, 15 U.S.C.A. § 6801(a).
- Disclosure of nonpublic personal financial information to a third-party
 - Is it non-public?
 - Is it to a third party?
 - *Lamarque v. Centreville Sav. Bank*, 22 A.3d 1136, 1141 (R.I. 2011) (finding disclosure of payoff amount of senior mortgage to purchaser of junior mortgagee's interest not violative of Gramm-Leach-Bliley and not an invasion of homeowner's privacy interests).
 - *Cf. Brush v. Wells Fargo Bank, N.A.*, 911 F.Supp.2d 445, 471 (S.D. Tex. 2013) (finding homeowner who inherited home from elderly father for whom she was caretaking had a right to assume mortgage, did assume mortgage through execution of loan modification agreement, and was therefore a consumer, "one who has a consumer debt," under the Texas Debt Collection Act).
- Exceptions cover disclosure to someone authorized by the consumer or in connection with a transaction authorized by the consumer, 15 U.S.C. § 6802(e)



Poll #3: Loans

- What kinds of loans are your successor-in-interest cases?
 - A. Government insured loans?
 - B. HAMP mods?
 - C. GSE loans?
 - D. Reverse mortgages?
 - E. Other?



Government Insured Loans

- All provide for assumability as a method of loan modification
 - Generally linked to credit screen
 - For FHA loans, clear no credit screen in event of death-related Garn categories
 - HUD Handbook 4330.1 Rev-5 Chapter 6



Non-Borrowers and HAMP Mods

- Requires servicer to stay foreclosure for non-borrower while assumption process chugs forward (8.9.2)
- Surviving homeowner remains eligible for new TPP, even if gets booted out of existing TPP (8.9.2)
- Surviving homeowner can and should be considered for mod, regardless of whether borrower was in TPP (8.8)
- 4(H) of Mod Agreement provides that transfers and assumptions as allowed by Garn are okay
- BUT suggests that “applicable law” or “investor guidelines” may forbid modification



Freddie Mac Guidance

- Provides for simultaneous modifications and assumptions, after borrower's death, by someone, "like a surviving spouse," with an ownership interest in the property
 - B65.12, B65.28 in the Single Family Seller Servicer Guide
 - Freddie Mac Bulletin 2013-3 (Feb. 15, 2013)
- Points of concern:
 - Can you get a HAMP mod or only a standard mod?
 - What happens in divorce?



Fannie Mae Guidance

- References “exempt” transactions—basically the Garn-St Germain exceptions
- Requires communication with new owners in exempt transactions
- Loan mod requests for new owners in exempt transactions have to be evaluated as if they came from borrowers
- See Fannie Mae Lender Letter LL-2013-04, also the Fannie Mae, Transfers of Ownership, Questions and Answers



HUD-Insured Reverse Mortgages

- *Bennett v. Donovan*, No. 11-0498 (D.D.C. Sept. 30, 2013) (non-homeowner spouse can stay in the property until death)
- Heirs can buy the property out of foreclosure for the lesser of 95% of the appraised value or the outstanding balance
- ML 2014-07 (prospective relief only)



Questions?



Poll #4: Clients

- Who are your clients?
 - A. Surviving spouse
 - B. Child
 - C. Ex-spouse
 - D. Other relative
 - E. Boyfriend/ girlfriend



What to Do for Boyfriends & Girlfriends?

- Consider bankruptcy
- Scrutinize the due-on-sale clause
 - Any limitations on the lender's exercise?
 - Possibility of good faith and fair dealing claim
- Ask for review for assumption if borrower creditworthy
 - Statute, regs, and legislative history all encourage mortgagees to consent to assumptions
 - Of course, would you want an assumption in that case??
 - Maybe for mortgage interest deduction or property settlement



Questions??

