

December 2009

THE NC CONNECTION

AN INVESTORS TITLE COMPANY PUBLICATION
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Mortgage Modifications

by Mike Aiken, Title Attorney
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In the current economic climate that we are facing, many lenders are reluctant to lend new money to borrowers. As a result, we are seeing more loan modifications. These modifications can have a significant impact with regard to the priority of the original deed of trust. The modifications could be interpreted as creating new debt that could be attacked by lien holders that were subordinate to the original deed of trust but may now have priority. Also, bankruptcy trustees are always looking for ways to decrease liabilities of the bankruptcy estate. Because of the increase in loan modifications, I felt it might be helpful to provide a brief discussion of some of the issues involved.

One of the fundamental misunderstandings that many lenders have regarding coverage provided by title insurance deals with the enforceability of the underlying note secured by a deed of

trust or mortgage. Title insurance does not guarantee the enforceability of the note nor the lender's ability to collect on the debt. Title insurance is designed to insure, as of the date of policy, the validity and priority of the deed of trust or mortgage given as security for the repayment of the note. It is also important to remember that an insurer's duty to defend is often broader than its liability under a claim. The process used by a bank to facilitate renewals and modifications should be discussed with bank counsel. When a lender modifies a note, and I use that term loosely, it is possible for them to extinguish the security for the note and to void their title insurance coverage. This possibility is best explained with a couple of examples most commonly encountered.

First is a situation where a lender, after the date of policy,

makes modifications to an existing note. These modifications could come in the form of an extension of payment terms, modifications to the interest rate, or a renewal of the note. The renewal is often encountered when dealing with a balloon mortgage. *Cont.*

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What happens to the coverage under the policy if there is an intervening lien between the date of the original note and the modification? Under the terms of the policy, the insurance company would defend any attacks on the validity or priority of the original deed of trust or mortgage where only a renewal has occurred, because the original policy will remain in effect and the insurance company would be liable subject to the conditions contained in the policy. If, as a result of the modification, additional funds are advanced or accrued interest is financed into the note, the duty to defend would still be applicable, but any losses suffered due to the advance or financing of interest are not covered because these are post policy events, created, suffered or assumed by the insured. This situation would most likely occur in bankruptcy where the judge could find that the changes did not attach to the mortgage.

The second situation is where the lender modifies an existing note and those modifications result in a novation. Black's Law Dictionary defines a novation as: "Substitution of a new contract, debt or obligation for an existing one, between the same or different parties." What happens to the coverage under the policy if there is an intervening lien between the date of the original note and the modification? If this event occurs, the title insurance company will have a duty to defend a challenge to the validity or priority of the deed of trust or mortgage. If, in the resulting litigation, it is determined that a novation has occurred, then the title insurance policy will no longer be in effect. Why? When a novation occurs, the original debt has been replaced and the judge rules that a new, unsecured note exists. As a result, the note is satisfied and the deed of trust or mortgage is no longer a valid lien on the property. Under the conditions of the policy, when the underlying debt is paid, the policy terminates. Additionally, the unenforceability of the original note is not a risk covered by the policy.

The final situation is where the lender advances additional funds after the date of the policy, to be secured by the original deed of trust or mortgage. This is typically in the form of a construction loan, future advance note or a credit line deed of trust or mortgage. What happens to the coverage under the policy if there is an intervening lien between the date of the original note and the subsequent advance? The title insurance company will still have a duty to defend, but the ultimate liability under the policy may be reduced or eliminated. As the principal of the indebtedness decreases, the amount of insurance is reduced pro tanto. Furthermore, the company is not liable for any indebtedness created subsequent to the date of policy except for advances made to protect the lien or to prevent deterioration of improvements.

Now that the situations have been laid out, the question becomes how to avoid these situations and what the lender needs to do to insure full coverage under the policy. First of all, it is imperative that the lender requests the appropriate endorsement from their title agent. In most cases, the issuance of the appropriate endorsement at the time of the policy will provide the lender with full protection.

When making a balloon mortgage, it is appropriate to request a Balloon Mortgage Endorsement. This endorsement will protect the lender against the unenforceability of the lien due to the exercise of a conditional right to refinance, an extension of the loan term, or a change in the rate of interest. It is still possible to obtain protection when the endorsement is not issued at the time of policy. The Balloon Mortgage Endorsement can be issued at the time of the modification.

Where the lender is replacing an existing note with a new note to be secured by the existing deed of trust or mortgage, it is appropriate to request an update endorsement. The update endorsement will reconfirm the coverage amount and advance the date of the policy to the date of the replacement note. In order to issue this endorsement, it is necessary to obtain an update on title, and any intervening matters will have to be dealt with to the underwriter's satisfaction.

If a lender is contemplating future advances at the time of the original loan, a Future Advances Endorsement should be requested. *Continued on page 3.*

Modifications *continued from page 2.*

If a lender is contemplating future advances at the time of the original loan, a Future Advances Endorsement should be requested. There are a number of various Future Advances Endorsements available ranging from endorsements for credit line loans to endorsements for obligatory and nonobligatory advances. Special construction loan endorsements are available in most states, and in most cases, additional requirements will be made and title updates will be necessary prior to each disbursement. Generally, these endorsements insure that future advances will relate back and have the same priority as the original deed of trust or mortgage. The endorsements do have exclusions for certain intervening liens such as state and federal tax liens and do not insure priority when the mortgagor has filed for bankruptcy.

We advise banks to discuss procedures with counsel for all renewals, modifications and extensions. Also, it is in the lender's best interest to discuss what coverage is needed with bank counsel and to determine which endorsements should be requested to provide that coverage. As always, the agency or branch personnel and Investors Title Insurance Company's Legal Department is available to provide guidance and direction.



Sharks in the Water—Avoiding the Attack

by Steve Brown, Title Attorney

In my years at Investors as the Senior Claims Manager and as a Title Attorney, I have been consistently amazed at the vast number of people, including real estate attorneys and paralegals who believe that title companies do not have to deal with many claims.

I hear statements and questions like: “You must have the easiest job in the world,” and “Do you guys really get claims?” By contrast, representatives of attorney malpractice carriers regularly state that real estate related claims result in a very high percentage of the claims dollars paid. Investors’ Claims Department currently has several claims attorneys and a number of non-attorney claims administrators who handle claims full time and Investors’ pays millions of dollars in claims each year. Clearly there are sharks in the water in the form of potential title problems at all times. Attacks are avoidable, however, for the vigilant. Watch out in future Claims Corners for tips on how to avoid an attack!

NC Fun Facts

The average yearly snow fall in NC is 5 inches. This amount can vary significantly for regional areas from the mountains to the coast.

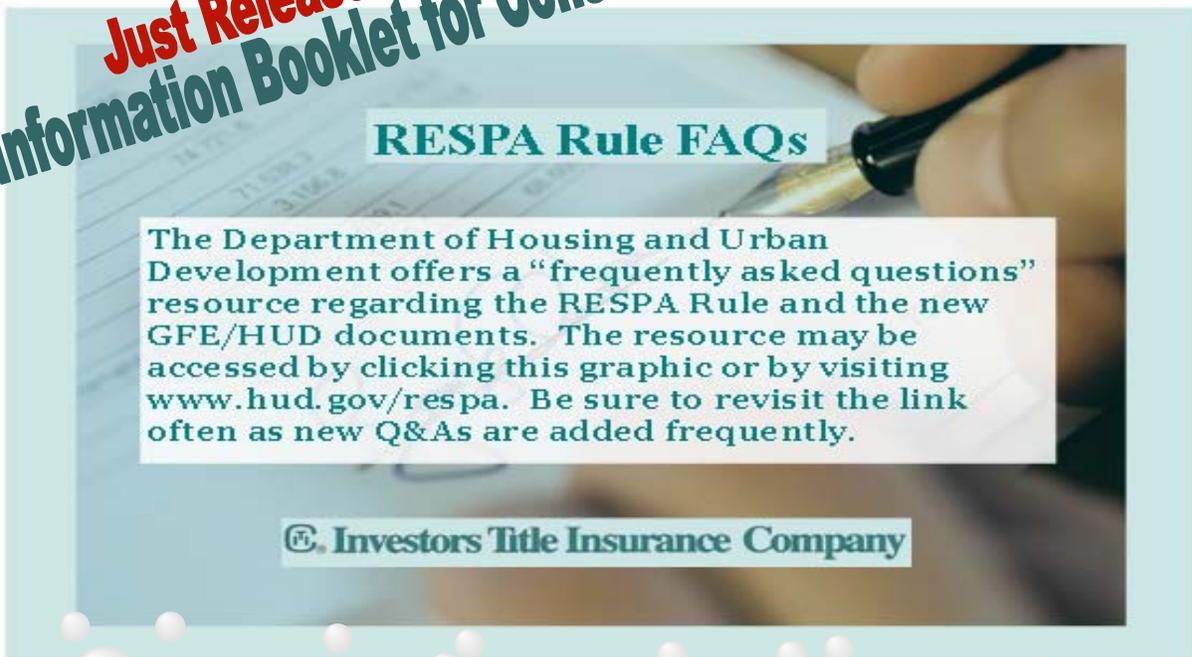
ALTA 10-06 Endorsement

This endorsement insures the lender against loss from failure of the assignment to vest title to the insured mortgage in the insured and any partial or full reconveyance or release of the insured lien recorded in the public records.

Issuance of this endorsement typically requires receipt of the following:

1. Assignee's name
2. Recording information for the Assignment. NOTE: The Assignment must be recorded to issue this endorsement.
3. Re-examination of the public records from the Date of Policy through the recording of the Assignment to identify any modification, partial or full reconveyance, release or discharge of the lien of the Insured Mortgage recorded on or prior to the date of the recording of the Assignment in the Public Records (other than those shown in the policy or on a prior endorsement).

Just Released:
HUD Information Booklet for Consumers

A graphic for a HUD Information Booklet for Consumers. It features a background image of a hand holding a pen over a document. The text is overlaid on this image. At the top, it says 'Just Released: HUD Information Booklet for Consumers'. Below that, the title 'RESPA Rule FAQs' is displayed. The main body of text describes a resource from the Department of Housing and Urban Development regarding the RESPA Rule and new GFE/HUD documents. At the bottom, it is attributed to Investors Title Insurance Company.

RESPA Rule FAQs

The Department of Housing and Urban Development offers a "frequently asked questions" resource regarding the RESPA Rule and the new GFE/HUD documents. The resource may be accessed by clicking this graphic or by visiting www.hud.gov/respa. Be sure to revisit the link often as new Q&As are added frequently.

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