New Jersey N2K Hour:

Underwriting Practices Pertaining to Mortgages

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Mortgage v. Deed of Trust

- A Mortgage is a legal contract or agreement in which the borrower (mortgagor) agrees to put up real estate as collateral for a loan.
- A Deed of Trust is a similar agreement where real property is pledged to secure a loan.
- However, while a mortgage only includes a borrower and lender, a Deed of Trust involves three parties, which include the borrower, lender, and trustee.
- The trustee is an independent third party which holds the property's title in trust, with the power of sale.

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Mortgage v. Deed of Trust

- In the event that the borrower defaults on loan payments, the trustee will handle the foreclosure process and sell the property at a public auction.
- NJ is strictly a mortgage state and a judicial foreclosure state.
- Typically, Deeds of Trust are used in states that have non-judicial foreclosures.
- Although Deeds of Trust are not typically used in NJ, you may still find a Deed of Trust in your county search if a borrower has taken out a reverse mortgage.
- If you come across a Deed of Trust in your search, please contact your underwriter for further guidance.

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Institutional Lenders

- An institutional lender can be one or more commercial or savings banks, savings and loan associations, trust companies, credit unions, industrial loan associations, insurance companies, or any other lender regularly engaged in financing the purchase, construction, or improvement of real estate.
- These lenders are typically regulated by the Federal Deposit Insurance Corporation (FDIC) or on the state level.
- Some examples of institutional lenders would be Bank of America, TD Bank, Wells Fargo, and Visions Federal Credit Union.

Private Lenders

- A private lender, as opposed to an institutional lender, is a person or entity other than a state or federally regulated banking or financial institution.
- If the lender is an LLC or corporation that is not regulated by the FDIC or the State of NJ, it is likely that they are a private lender.
- When dealing with a private lender, please be sure you obtain any organizational documents that the lender may have to confirm the authorized officers of the entity.
- Also, when a private lender provides a payoff statement, you are required to obtain a Discharge of Mortgage from the private lender prior to closing.

SBA Loans

- An SBA loan is a small-business loan which is partially guaranteed by the U.S. Small Business Administration and issued by participating lenders, which are typically banks or other institutional lenders.
- This type of loan usually has flexible terms for the borrower and a low interest rate.
- However, the lender requirements can be very strict, even from an underwriting standpoint for title insurance.
- Typically, we see SBA loans issued for commercial transactions.

SBA Loans (cont.)

- SBA loans often times may use other properties as additional collateral for the loan, and we may even have to insure an SBA loan in second lien position.
- Please be aware that an SBA lender may ask for a combined loan policy, which requires additional searches for the properties that are being used as collateral.
- If your search discloses one or several open mortgages on the other properties, then these mortgages must be listed as exceptions on the loan policy for the SBA loan.
- If an SBA lender asks for any special type of affirmative coverage, please consult your underwriter for guidance.

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Hard Money Loans

- A hard money loan is generally a short-term loan, with a higher than current interest rate and a very short term, usually 1-5 years.
- These loans are often issued by private lenders to borrowers who don't have great credit.
- A hard money lender will instead weigh the merits of the investment that a borrower is looking to fund and use that investment as collateral.
- Hard money loans are considered very risky from a title insurance standpoint.

Hard Money Loans (cont.)

- One of the risk factors with hard money lender transactions is that many of these lenders conduct very minimal due diligence on the borrower or on the property.
- Essentially the hard money lender relies on the perceived value of the property and the coverage provided in the title insurance policy.
- As a result, hard money lender transactions may be significant targets for fraud.
- Therefore, we would need to carefully review the transaction to make sure there are no red flags, so we can proceed in insuring the loan.
- Please consult your underwriter for further guidance.

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Reverse Mortgages

- A reverse mortgage loan allows homeowners to borrow money using their home as security for the loan.
- However, for a reverse mortgage loan, borrowers don’t make monthly mortgage payments, and the loan is repaid when the borrower no longer lives in the home.
- Interest and fees are added to the loan balance each month and the balance grows.
- As the loan balance increases, your home equity decreases.
- Reverse mortgage loans are typically promoted to older homeowners.

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Reverse Mortgages (cont.)

- Please be aware that the U.S. Federal Government also offers reverse mortgages to borrowers, which is called a Home Equity Conversion Mortgage (HECM).
- This type of mortgage is only available through an FHA-approved lender.
- When the borrower takes out a HECM, two separate mortgages will be recorded at the County for the same reverse mortgage loan.
- The first mortgage will be in favor of the FHA-approved lender, and the second mortgage will be in favor of HUD.
- When obtaining a payoff for a HECM, please be sure that two Discharges are received from the lender and HUD.

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Islamic Financing

- Islamic financing or Sharia-compliant financing is banking or financing activity that complies with Sharia law and its practical application through the development of Islamic economics.
- "Sharia" law are the rules and practices of Islam governing the practice of Muslims.
- This type of financing is also a method of sale with a mark-up price whereby the borrower makes payment over an agreed period of time.
- The underlying asset for the sale transaction between the borrower and the lender will be a specific tradable Shariah-compliant commodity, which includes real property.

Islamic Financing (cont.)

- This type of financing also does not allow payment of interest on the loan.
- An example would be an individual (borrower) who is acquiring or refinancing on a residence.
- The borrower will sign a Co-Ownership Agreement with a single purpose LLC established to facilitate a home acquisition (or refinance) Transaction.
- The LLC will be a Co-Owner by contract with the borrower, pursuant to the terms of the Co-Ownership Agreement, but will not be shown as a grantee on the deed to the borrower.

Islamic Financing (cont.)

- The undivided interest of the LLC will decline as payments are made by the borrower.
- Documents for the transaction will generally include a Co-Ownership Agreement, an Obligation to Pay which provides that the borrower agrees to pay a monthly payment, including profit payments, acquisition payments, and other payments.
- Also, the insured Mortgage executed by the borrower, along with the Assignment Agreement from the Co-Owner to the LLC.
- Lastly, the Deed from the third party solely to the borrower if we are insuring a purchase transaction.

Mortgage Discharges and Partial Releases

- A Discharge of Mortgage must be prepared and executed by the lender of record to release an open mortgage of record once it is paid off.
- If a mortgage encumbers several properties, a lender may prepare a document known as a Partial Release of Mortgage, which would release a specific property from an underlying mortgage.
- When paying off a mortgage for a specific property, please follow up with the lender to make sure a Discharge or Partial Release is prepared, so it can be sent for recording after the closing.

Assignment of Mortgage and the ALTA 10 Series

- In NJ, we offer the ALTA 10 series for an assignment of mortgage.
- An assignment of mortgage occurs when a lender sells or transfers your mortgage to another investor or lender.
- Once this transfer occurs, the original priority of the mortgage remains unchanged.
- Assignments of Mortgage are typically recorded in the County, but there are some assignments that can be unrecorded.
- The ALTA 10-06 insures against loss or damage resulting from the failure of the assignment to transfer title to the Insured Mortgage in the Assignee.

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Assignment of Mortgage and the ALTA 10 Series (cont.)

- The ALTA 10-06 also insures the transferee of the insured mortgage and the secured note that the transfer of mortgage is valid, provided that the note has been properly endorsed and delivered to the transferee, or if the note or notes are transferable records, the insured has "control" of the single authoritative copy of each "transferable record" as these terms are defined by applicable electronic transaction laws.
- We can also issue the ALTA 10.1-06 endorsement if the lender wants date down coverage regarding the assignment.
- However, the ALTA 10.1 does require a rundown search.

Mortgage Modifications

- A mortgage modification is usually done to change the terms of your original mortgage agreement.
- If a borrower has encountered a financial setback which can lead to a default in payment, a lender will normally work with the borrower to modify their loan, so timely payments can still be made.
- A mortgage modification can be structured in a way where the mortgage is more affordable to the borrower, such as a lower interest rate, extension of the loan, or a lower payment for each month.

ALTA 11-06 Endorsement

- The ALTA 11-06 endorsement is issued for a mortgage modification in NJ.
- Unlike other states, NJ does **NOT** offer date down coverage for a mortgage modification.
- We can issue the ALTA 11-06 endorsement if Stewart was the insurer on the original loan policy.
- However, if the original policy was issued by another underwriter, then we would have to issue a new loan policy based on the modification rate in the NJ Rate Manual.

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ALTA 11-06 Endorsement (cont.)

- This endorsement insures the lender against loss or damage sustained by the Insured by reason of: (a) the invalidity or unenforceability of the lien of the Insured Mortgage upon the Title as a result of the Modification; and (b) the lack of priority of the lien of the Insured Mortgage over defects in or liens or encumbrances on the Title, except those in the policy and prior endorsements and except those set forth in the endorsement.
- The endorsement does not insure against creditors' rights issues arising out of the modification.

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Construction Loans

- If you are insuring a construction loan, please be sure to add the pending disbursements exception in Schedule B of the loan policy.
- The pending disbursements exception provides that the policy insures only to the extent of the amount actually disbursed but increases as each disbursement is made in good faith for the payment of construction costs, up to the face amount of the policy.
- However, this exception still accounts for a continued rundown search which will disclose any potential Notices of Unpaid Balance or Construction Liens that need to be discharged of record.

Construction Loan Endorsements

- In NJ, only two endorsements are available for construction loans.
- The first endorsement is the Special Construction Loan Policy endorsement, which converts the loan policy into a special construction loan policy.
- Please keep in mind that coverage on a construction loan policy will expire three years from its effective date, and the lender would need to obtain a permanent loan policy by paying the balance of the applicable underwriting rate on or before the expiration date.

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Construction Loan Endorsements (cont.)

- The second endorsement available for a construction loan is the ALTA 33 (Disbursement) endorsement.
- This endorsement provides a vehicle by which the Date of Disbursement Coverage under the said policy can be amended to the date of the current disbursement.
- Both of these endorsements are not required but they can be issued for a loan policy at the request of the lender.
- Please consult your underwriter for further questions regarding construction loans or available endorsements in NJ.

ALTA 14 Series and Future Advances

- The ALTA 14-06 insures against loss or damage sustained by the Insured by reason of: (1) invalidity or unenforceability of the insured mortgage as security for Advances; (2) lack of priority of the lien of the insured mortgage as security for Advances; and (3) invalidity or unenforceability of the mortgage because of Re-Advances and repayments, lack of outstanding debt before an Advance, and failure to comply with legal requirements for Advances; (4) invalidity or unenforceability of the insured mortgage because of adjustment of interest or addition of interest to principal, and (5) loss of priority of the insured mortgage caused by adjustment of interest rates and addition of interest to principal.

ALTA 14 Series and Future Advances (cont.)

- This endorsement is designed for insurance of priority of advances, regardless of whether the lender knows of the intervening liens and other matters.
- This endorsement also contains exclusions from coverage for advances after a bankruptcy, real estate taxes and assessments, federal tax liens filed more than 45 days before the advance, federal or state environmental protection liens, and usury or consumer credit protection or truth in lending law.

ALTA 14 Series and Future Advances (cont.)

- When issuing this endorsement, you must verify the mortgage expressly secures future advances and complies with applicable state requirements for disclosure of future advances.
- Verify the mortgage establishes a maximum time and amount for advances.
- This endorsement does require underwriter approval, so please request a copy of the mortgage and consult your underwriter before issuing this endorsement on a loan policy.

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ALTA 14 Series and Future Advances (cont.)

- NJ also offers the ALTA 14.1-06 (Future Advance – Knowledge); ALTA 14.2-06 (Future Advance – Letter of Credit); and ALTA 14.3-06 (Future Advance – Reverse Mortgage) endorsements.
- Please consult your underwriter for further guidance if a lender requests any of the ALTA 14 series for their loan policy.

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SWAP Agreements and the ALTA 29 Series

- An interest rate swap is an agreement between two parties to exchange one stream of interest payments for another, over a set period of time.
- In NJ, the ALTA 29 series is provided for loan policies for an interest rate swap obligation on a mortgage.
- This endorsement insures against (1) invalidity or unenforceability of the insured mortgage as security for the repayment of the Swap Obligation; (2) lack of priority of the lien of the insured mortgage as security for the repayment of the Swap Obligation.

SWAP Agreements and the ALTA 29 Series

- The mortgage must expressly secure the Swap Obligation and comply with applicable state requirements for disclosure of Swap Obligations, if applicable.
- The swap obligation must be evidenced by an existing master swap agreement and confirmation, and the mortgage also must establish a maximum amount of the Swap Obligation.
- NJ offers the ALTA 29-06 (Direct Obligation); ALTA 29.1-06 (Additional Interest); ALTA 29.2-06 (DO – Defined Amount); and the ALTA 29.3-06 (AI – Defined Amount) endorsements.
- Underwriter approval is required for issuance on any of these endorsements.

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Variable Rate Mortgages

- A variable-rate mortgage, or commonly known as an adjustable-rate mortgage, is a mortgage loan with the interest rate on the note periodically adjusted based on an index which reflects the cost to the lender of borrowing on the credit markets.
- In NJ, we offer the ALTA 6 Series for variable rate mortgages (ALTA 6-06 and ALTA 6.2-06).
- Please note that you must confirm that the mortgage secures a variable rate before issuing this endorsement on a loan policy.

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Balloon Loan Modification

- Balloon mortgages are generally mortgages which are fully due and payable before the payments required by the terms of the mortgage note will fully repay the loan amount.
- The balloon feature is used in some loans to protect the lender from a significant change in the interest rate.
- If interest rates rise, the lender does not have to wait thirty years before it can call the loan. The benefit to the borrower is lower monthly payments.
- As these balloon mortgages come due many lenders are willing to "roll over" the loans if the borrower is still credit worthy.

Balloon Loan Modification Policy

- NJ offers a Balloon Loan Modification Policy, which insures only the validity of the "roll over" and the continued priority of the mortgage.
- If you have already insured the mortgage which will be "rolled over", you need only continue the title through the recording of the mortgage modification which extends the due date of the loan.
- If the searches disclose any liens filed or recorded either after the date of the mortgage being modified or which were not properly discharged at the time the original mortgage was recorded, then such liens must be discharged of record before issuing this policy.

Partial Release of Mortgaged Premises

- NJ offers a Partial Release of Mortgaged Premises Endorsement for loan policies, if a lender executes a Partial Release on a loan and wishes to have the endorsement update their loan policy.
- This mortgage insures against loss or damage sustained by the insured in the event that the Insured Mortgage does not remain a valid and enforceable lien on that portion of the Land not released in the Partial Release of Mortgage.
- It also insures against loss or damage sustained by the insured that the priority of the lien of the Insured Mortgage, on that portion of the Land not released, is adversely affected by the Release.

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Additional Underwriting Requirements for Mortgages

- Please always ask the lender for a copy or draft of the mortgage that we will be insuring.
- Aside from any affirmative coverage or endorsements that the lender may request, we must make sure that the borrower on the mortgage is the same as the individual or entity on title to the property.
- If a lender wants to place additional collateral on the loan, you must run title searches on the additional properties, and include exceptions on the loan policy for any encumbrances which affect the collateral parcels.
- Please consult your underwriter for any questions on these requirements.

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Wrap Up and Review

- NJ is strictly a mortgage state and a judicial foreclosure state.
- There is a significant difference between private lenders and institutional lenders, so please be sure to use additional scrutiny when dealing with a private lender.
- Please be mindful when dealing with hard money loan transactions, as these transactions tend to have a great deal of risk in terms of underwriting.
- Always consult your underwriter before issuing certain endorsements on a loan policy. We may require additional information from the lender or a copy of the mortgage for review before issuing a specific endorsement.

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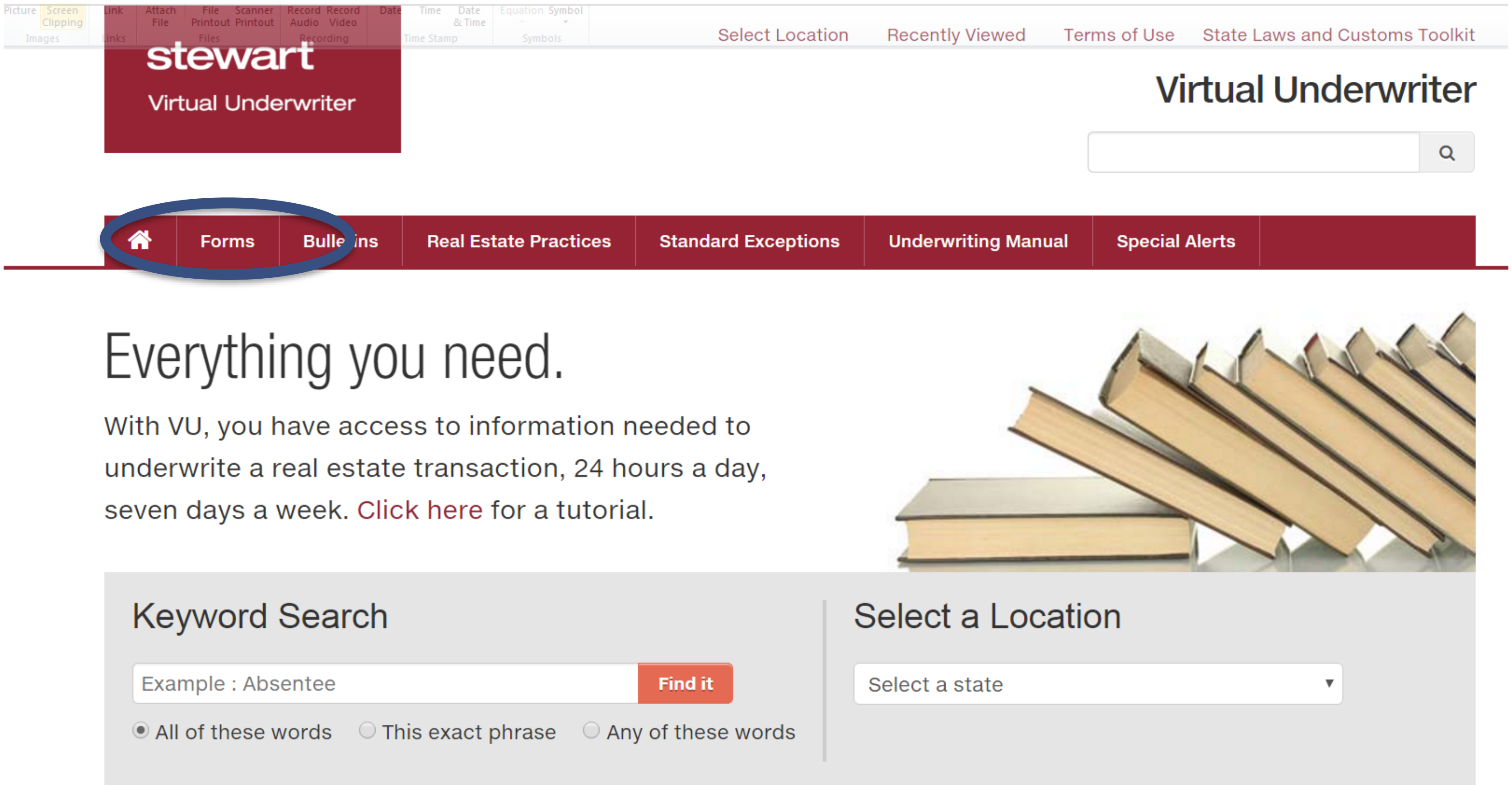

Virtual Underwriter

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