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Mortgage Loans - A Free Ticket to Litigation

Litigation regarding mortgage loans (like all of Gaul) can be divided into three parts: 1) Origination, 2) Loan Servicing, and 3) Collection. Of course, none of these areas becomes the subject of dispute until the mortgage loan cannot be paid in regular order. Once repayment on the underlying obligation(s) becomes questionable, each or all of the three areas are subject to scrutiny, criticism or litigation from any of the parties. What begins as a claim regarding servicing, collection, or origination usually spills over into the other areas as claims progress. Further, the spillover includes not only the lender and borrower, but also title insurers, appraisers, disbursement companies, construction management, realtors, etc. While I could easily regale you with examples of weird cases I have seen recently, it would be much more useful to focus on the issues you are most likely to encounter.

Before outlining the most frequent issues in each of the three general categories above, it is instructive to note that, as an expert, I cannot and should not attempt to render opinions on the law or outside my area of expertise. Most of the cases I have been involved in pivot on following or deviating from standards, practices, policies, or procedures of the industry. That said, let's get down to the business of looking at the most common causes of disputes

Origination

Unless the lender originated a loan or loans and held that loan or those loans in their own portfolios for investment, every step of the origination process is subject to question. With respect to individual loans, misrepresentations by borrowers, loan brokers, appraisers, title insurers and mortgage bankers almost inevitably lead to disputes from the current holder of the beneficial interest. Misrepresentations can be intentional or unintentional; however, they usually result in a request for a "buy back" from the investor and subsequent dispute resolution if the buy back request is not met. There is little to discuss regarding intentional misrepresentation. Unintentional misrepresentation is normally caused by inadequately trained staff, insufficient management structure (internal checks and balances) or both. This holds true for not only individual loans, but for pools of loans sold in the secondary market or securitized by way of mortgage-backed securities. The latter has been widely reported in the press in recent days. While the key issues for individual loans revolve around underwriting practices, there are additional issues for bulk purchases and securitized pools concerning the proportions of certain "quality" loans included in a particular package of loans. In either case, disputes are usually resolved in favor of the party that most closely adhered to industry standards, best practices, policies and procedures.

Servicing

Disputes regarding loan servicing come from one of three parties: 1) the borrower, 2) the loan servicer (if different from the investor), and/or 3) the investor. Leaving aside loans properly underwritten where the borrower simply can't or won't pay, efforts to modify or even just enforce the terms of a loan are fraught with problems in the current market. The common theme of any variation of servicing dispute is someone's failure to properly communicate and document the situation. In residential mortgages, it frequently occurs where some or all of the parties have a completely different view of the same "agreement." As an example, a homeowner and an employee on the lending side of the equation agree to modify a mortgage loan, but there is miscommunication on the lending side. The homeowner performs according to the "agreement" only to wake up one morning to learn that the property has been foreclosed upon and sold. If you think this doesn't happen, read the newspapers.

Similar situations occur with commercial loans. The most common occurrence is in the area of construction lending. In my experience, the construction loan agreement is, perhaps, the most misunderstood document in commercial real estate lending today. Both borrowers and lenders rely on this document without connecting their reliance to industry best standards and practices. Things that can go wrong in a construction loan come in every variety, with both sides pointing the finger at the other "based upon the language in the construction loan agreement." Less frequent but not unheard of are disputes revolving around the rights and remedies granted to a lender in a mortgage or deed of trust. Failures, perceived or real, to comply with the terms of one of these documents often leads to less than favorable relationships between a borrower and a servicer or lender resulting in litigation. Particularly with residential loans, class actions are more and more common.

Given the economic climate and resulting dramatic rise in real estate loan litigation, efforts to properly resolve troubled situations are more critical now than ever. There is a solution. Hopefully there has been little or no previous miscommunication and all pertinent areas have been documented, yet there is still a need to somehow "modify" existing agreements. Be certain to obtain a "pre-negotiation" letter before entering into any sort of loan modification or forbearance agreement. Don't be surprised if either of these documents contains a waiver of lender liability for previous acts. Such provisions have risen in popularity in proportion to the rise in lender liability lawsuits.

As stated earlier, issues can arise with pooled or securitized loans between an originator, a servicer, and an investor even in commercial real estate loans. A simple example to illustrate this point is the case of a "participated" or "agented" credit. Disputes involving an originator, servicer, or investor in such commercial loans (sometimes commonly called bank on bank litigation) are growing rapidly. Although much larger sums are involved in commercial loans, especially credits shared between lenders, the answers are the same. Answer the questions: What did you know? When did you know it? What did you do about it? Did you document all of the circumstances? Did your actions comport with policies, procedures, industry best practices and standards? If you can answer those questions satisfactorily, rest *easier*.

Collection

Let me first say that this section was called collection because I thought that word was less nasty than foreclosure. When circumstances lead you to a point where the only source of repayment is recourse to the mortgage or deed of trust collateral, that is usually called foreclosure. Anything less, such as a deed in lieu of foreclosure, is probably covered by the previous section.

Before moving on to the details of collection, it is very important that I give you the most common error that I see made by lenders in any type of mortgage lending. Don't try to sell something you don't own! So many times, lenders in a misguided effort to rush that potential OREO off the books will take some action to facilitate the sale of property they don't yet own. This error is usually committed by less experienced or poorly supervised lenders, but there is no exclusive franchise on who can make this mistake. A less common but more damaging occurrence is to try to liquidate the collateral to a not completely arms-length party. Either mistake will almost certainly guarantee some sort of interference claim.

In the out-of-fashion news today: Robo-Signing. If you haven't heard about this, you must be living under a rock. Twenty-three states require, as part of the foreclosure process, an affidavit from the beneficial owner or servicer stating that they have reviewed all the foreclosure- related documents and that the requested foreclosure action is proper. The current flap over Robo-Singing is that the affiant did not, in fact, complete the review as required. A somewhat related issue has also come up in recent months. It is an issue of legal standing. Most frequently in loans involving MERS (mortgage electronic registration systems) –electronic mortgage recording and transfer–, but also in other circumstances, a question of exactly who is the beneficial owner of a mortgage legally eligible to pursue foreclosure has also arisen. As a result, some foreclosure actions have been denied, and in a few cases, the court has asked for actual wet-sealed documents.

A final note on the foreclosure process. Notwithstanding the language in your mortgage or deed of trust, many states have recently passed legislation, at minimum, imposing additional requirements on a lender's ability to foreclose. Make sure you know the current state of affairs with respect to your particular venue.

In summary, all of the issues we have discussed have a common genesis. Poorly trained staff and insufficient or inadequate management structure in place to ensure compliance are the start. Lack of documentation for whatever actions are taken and the reasons for doing so add to the problems. Not knowing and meeting industry best practices and standards, as well as not complying with policies and procedures, can be the final blow.

This article discusses issues of general interest and does not give any specific legal, medical, or business advice pertaining to any specific circumstances. Before acting upon any of its information, you should obtain appropriate advice from a lawyer or other qualified professional.

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