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A Lawyer's Perspective

Mortgage loan origination

BY DENNIS SCARDILLI

There are different styles for problem solving: Barack Obama's studied analysis; John McCain's top-gun intuitiveness. Neither is always the right style nor is neither always wrong. It depends on the issue at hand. I say this to prepare you for my analytical approach to the mortgage foreclosure crisis over the next several weeks. With the help of experts in those fields, we will attempt to determine if there really is a means of reducing the number of mortgage foreclosures and how the issue can be addressed, in both the public and private sectors.

Turning potential foreclosures into loan workouts is an important issue whether you are in danger of foreclosure or "just" want to keep your home's value from plummeting due to increased foreclosures in your market. Determination of "how" is fast becoming a national economic priority.

The answer is best found through a dialogue with the people who work on the financial industry side of the mortgage and foreclosure problem. From Main Street to Wall Street, that industry is now the key to developing a solution.

Let's start by walking through the mortgage loan origination process. My former-Realtor-colleague-turned mortgage broker Harry Mehlman of Franklin-American Mortgage Company was kind enough to provide me with an explanation of the mortgage origination process. I have then contrasted Harry's explanation of today's practices with those that caused the mortgage meltdown.

In a loan officer's first meeting with home buyers, he receives approval to obtain their credit report and asks questions to determine their ability to qualify for a mortgage. Based on their initial representations of income, current debts and credit score, he estimates the mortgage payment for the amount of mortgage financed. If they decide to go forward, the lender issues a pre-qualification letter. The loan officer then goes through the mortgage application with the buyers and the lender processes that application.

In foreclosure litigation, both civil and criminal, many borrowers have alleged that they did not understand the ramifications of the mortgage instrument that they had signed or the payment for which they were obligating themselves. This may be considered a plausible argument, under certain circumstances, particularly when that instrument involved an Adjustable Rate Mortgage (ARM) with multiple permutations of rate adjustments.

Today, mortgage lenders assign a processor who verifies the information provided by the buyer/mortgagor, including employment, money in the bank, total debts, etc. In the past, lenders widely accepted "limited documentation" or "no doc" loans, where the credit underwriting was based primarily on representations by the borrower. There have been numerous criminal prosecutions where the applicant and/or lender provided or used fraudulent information to process the loan.

A national lender has recently entered into a settlement agreement, spearheaded by Arizona Attorney General Terry Goddard. That company's successor entity has agreed to modify loans for almost 400,000 borrowers, resulting in an $8 billion payback with $150 million going to state programs for foreclosure relief to help their predecessor's customers.

After the application is processed, a final mortgage commitment letter is issued, often with conditions. These can include: a clear title report; a survey showing no encroachments; testing of private well and/or septic systems; an appraisal that supports the purchase price; and, repairs identified by the appraiser. Today, reputable lenders carefully scrutinize those conditions. Past practices have resulted in litigation where repairs were pumped up to funnel money from the seller back to the buyer, creating phantom equity where really there was none. Alternately, buyers have sometimes been stuck with shoddy work or falsification of repairs. New York Attorney General Andrew Cuomo, and others, accused some lenders of demanding rubber stamp appraisals that mirrored the transaction price on a contract of sale. This led Congress to include preliminary provisions for "appraiser independence" in the housing legislation passed last summer.

After all mortgage commitment issues have been resolved, the loan closing is usually held, in our area, at a title company. During the closing, the title company will receive the mortgage loan funds, and then disburse the proceeds to the seller and/or their mortgage holder, the appraiser and for other closing expenses. The title company also collects the buyer/mortgagor's pre-payments and escrows real estate taxes and homeowner's insurance.

A miniscule percentage of single-family residential closings include lawyers in South Jersey. Would a lawyer catch the above-referenced problems in mortgage loan origination? The lawyerly answer is: it depends …. on you. Hire an experienced attorney. Have him or her review the entire closing file well before the closing date and pay for their time. In recent mediations I have conducted, the cost to litigate issues in the magnitude of those discussed above was estimated at $15,000 to $50,000. Is it worth a grand or so to cover your back? You betcha!

After the closing, the lender most likely will sell the mortgage, along with hundreds or thousands of others, on the secondary mortgage market. Workout inquiries may get no response from a loan servicer because the loan holder is in Abu Dhabi. Stay tuned, as we next see how a mortgage is packaged and sold to those investors.

Dennis Scardilli practices as an attorney-at-law in the Atlantic City area. The information in this article has been provided only for informational and educational purposes and is not intended to provide legal advice. For legal advice on this, or any other, topic contact a qualified attorney.