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Let the Lender Beware: Avoiding Problems



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Most states allow, or require, perfection of a security interest in a manufactured

home by a lien notation on a certificate of title (COT, or title) which should be filed with the state's Department of Motor Vehicles, just as a lender would note an automobile loan on a car title. However, servicers and investors, foreclosure attorneys, and closing and title attorneys have become painfully aware that this is not the case with many manufactured home loans in their portfolio.

The following are some common sense, practical tips to avoid the expense involved in remediating an improperly originated or perfected loan. These expenses can mean thousands of dollars to the lender, and include fees associated with obtaining duplicate title, surrender of title, publication costs, service of process, bonding costs, attorneys' fees, and holding costs.

Personal Property to Real Estate

Manufactured homes are homes constructed in a factory setting in accordance with the federal Manufactured Home Construction and Safety Standard Act (HUD Code), enacted in 1976, and enforced by HUD. We often use the term "mobile home" interchangeably with "manufactured home," but the mobile home terminology technically applies only to factory-built homes produced prior to the enactment of the HUD Code in 1976.

All manufactured homes begin their lives as personal property and, as mentioned above, a lien on a manufactured home is perfected by a notation on the COT. Most states, however, also have procedures to convert a

manufactured home to real estate, thus allowing the lender to secure all of its collateral (the land and the manufactured home) with one security instrument — a deed of trust or mortgage. Theoretically, this process should help both the borrower and the lender. The lender benefits because there are no doubts as to its security interest in the collateral for which it made the loan, and the borrower benefits because a loan on real estate typically has a lower interest rate compared to a personal property loan.

Then why do so many originating lenders fail to properly perfect their interest in the home? Excuses range from ignorance of the process, to mistakes or oversights by the title and closing agent, to the cost and time involved, even to an unawareness of the consequences and costs associated with a failure to perfect.

Assurance of Perfection

Why should lenders deal with this cumbersome issue at origination? To avoid the problems that arise in case of the borrower's default. Specifically, servicers can (1) proceed with foreclosure without concern as to their interest in the collateral, (2) expect faster timelines and lower holding costs in both foreclosure and REO, (3) prevent a bankruptcy trustee from avoiding the lien because it was not properly perfected, and (4) prevent a borrower from pawning (or otherwise borrowing funds on) his manufactured home title because the lender's lien was not noted on the COT.

Servicers with manufactured housing loans originated and serviced in their own shops, or purchased in bulk or from brokers, need assurances from the originators that they are receiving properly perfected liens. In Arkansas and Tennessee, the lien should be properly noted on an original COT, or converted to realty and included in the title insurance policy with an American Land Title Association 7 Endorsement. One of these two documents should be in the loan file.

Curing an "Imperfection"

In many instances, a servicer ends up with a file without the original COT or a policy with an ALTA 7. In these instances, there are other documents that can be of significant assistance to your attorney in expeditiously handling the curative work necessary to maintain the security interest in, and if necessary, take title to the home. If the borrower disputes the security interest in the home, evidence of the borrower's intent to use the mobile home as collateral is critical. Key documents to have in the file would include the closing instructions, the appraisal, and the loan application. This information can mean all the difference in achieving a positive result in case of default.

If no documents exist, there are still some opportunities to complete an incomplete file. In any loss mitigation efforts, the servicer should ask the borrower if he has the original COT in his possession. This is the time to get it. After the servicer has the title in its possession, it should note its lien on the title and register the lien with the state DMV. If the borrower says he doesn't have the original, the servicer should attempt to get a power of attorney for the purpose of obtaining a duplicate title with its lien noted. The servicer's attorney will be able to help with this process.

Another opportunity, often not as friendly as in a loss mitigation situation, is subsequent to the foreclosure sale. The attorney can attempt to obtain the COT or a power of attorney during the curative process prior to the REO sale. This negotiation might cost a few hundred dollars, but would be less expensive than proceeding through the duplicate title, surrender, and conversion process necessary to convey real property to the REO purchaser. At this stage, time is of the essence because, if the borrower does have the original title, he could sell it, pawn it, or obtain a loan against it while you are trying to market the REO.

To avoid these issues, problems, and losses, all that a servicer needs to do is to make sure that the lien is perfected at origination! ■