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TITLE ALERT

Title Alert 2015-01 **January 29, 2015**

Post Foreclosure Underwriting: One-to-Four Family REO Properties
First American Title Insurance Co. National Underwriting Communication

Attached is a National Underwriting Communication (NA 2014 – 006) issued by the Home Office relating to REO Property. This Communication is national in scope and intended to provide additional guidance in conjunction with the Pennsylvania Communications listed below.

In Pennsylvania, we have issued the following Communications relating to this issue:

Title Alert 2010-16: REO Sales Risk Assessment Bulletin
Title Alert 2012-06: Defective Act 91 Notice
Title Alert 2012-12: Recent Legislation Affecting Foreclosures Involving Defective Act 91 Notice

First American Title

UNDERWRITING COMMUNICATION

Issued by

First American Title Insurance Company

NA-2014- 006 -Standard

Title: **Post Foreclosure Underwriting: One-to-Four Family REO Properties**

Issued By: Corporate Underwriting Department

Written By: Foreclosure/REO/Distressed Property Practice Group
Jay Dobson, Chairperson

Date Effective: December 1, 2014

Purpose:

This communication updates and supplements those prior bulletins of a general or non-state specific nature, issued in the fall of 2010, dealing with insurance on the sale of one-to-four family residential REO property. Where a State Office has issued a Communication that requires application of state-specific underwriting direction, such Communication must be followed, as well.

By "REO Property," this communication covers one-to-four family residential property acquired by an institutional lender or servicer (including its affiliate, subsidiary or guarantor) through the foreclosure of a deed of trust or mortgage on residential property and that is now being sold to a bona fide purchaser[1].

It does not cover

- A subsequent transaction from that bona fide purchaser to a subsequent bona fide purchaser
- property acquired via a deed in lieu of foreclosure
- property acquired through a foreclosure by a third party investor, either through a foreclosure of a deed of trust or mortgage that it acquired or as a high bidder at someone else's foreclosure auction.

The transactions not covered by this Communication may involve similar risks and other concerns and, while the attached Checklist has been designed as a tool in the evaluation of the risks relating to REO property as defined above, it may be used to assist in your evaluation of those risks, as well. You must also follow any state-specific Communications or seek guidance from your State Underwriting Department relative to insuring any of those other types of transactions.

Background:

Changes in applicable statutes, as well as court decisions interpreting existing law relating to foreclosures have continued to result in a changing view of how the risks involved in insuring title to REO Properties can be underwritten. The developing circumstances and facts and continuing discussions with our agents and customers have resulted in adjustments to our underwriting approach.

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[1] *A Bona Fide Purchaser a/k/a BFP: A purchaser in good faith for valuable consideration and without notice of defects or claims. (Black's Law Dictionary).*

The risks associated with insuring residential REO Property are basically threefold:

1. Possession: By far, the greatest indicia of risk to insuring REO Properties arises when the borrower and/or his successor in interest is still in possession of the property. In many cases, these parties have nowhere else to go, and will stall for time by contesting the validity of the foreclosure. The motivation to contest a foreclosure diminishes, the longer the borrower has vacated or abandoned the property.

2. Equity: Equity, or value remaining in the property, is the second leading motivation for a borrower to contest the validity of a foreclosure. If there is simply no equity or value in the property as it was encumbered prior to the foreclosure, there is little reason for the borrower to want title to it. On the other hand, if the property is presently worth substantially more than the liens that previously encumbered the property, there is motivation to attack the foreclosure in order to get the benefit of that equity.

3. Foreclosure Defects: Any defect in the foreclosure process may give the borrower the means by which to attack the foreclosure and title of the REO purchaser.

In evaluating the risks prior to insuring a transaction, not only must we consider the likelihood of eventual success in defending the title to the property, but also the potential cost in defending that title.

The REO checklist that accompanied the 2010 communications has been updated to more clearly set out the ongoing and new risks due to the changes in the statutory landscape and corresponding court interpretations. A copy of that checklist is attached as Exhibit 1 to this communication. In addition, an annotated version of the checklist appears as Exhibit 2 and adds commentary as to what issues the questions are designed to address and why. Reviewing this annotated version may provide additional insight into the issues that are to be considered when underwriting the transaction.

Standard/Guideline: In evaluating any sale of residential REO Property by an institutional lender, its servicer, affiliate, subsidiary or guarantor, the following procedure must be followed:

1. Examine the foreclosure process according to your State Underwriting Standards including, but not limited to:
   a. In a judicial foreclosure, review of the case file to verify service of process, compliance with any conditions precedent to a default judgment (such as production of a “Non-Military Affidavit” under the Service Member’s Civil Relief Act), satisfaction of requirements regarding notice of sale (including publication), the filing of a report of sale and the issuance of the certificate of title and/or referee’s deed.

   b. In a non-judicial foreclosure sale, any certification of compliance, Non- Military Affidavit (or other proof of compliance), and compliance with the applicable non-judicial foreclosure procedure under which the foreclosure was done.

2. In addition, an REO Sale Risk Assessment Checklist (form attached) must be completed for each transaction. All questions must be answered with the “Yes” or “No” line checked. The REO Sale Risk Assessment Checklist must be dated and signed by the title officer, examiner or approved examining attorney reviewing the title and maintained in the title file. If all questions have a “No” answer, you are authorized to issue a commitment or policy on behalf of the Company, subject to any other risk limitations that may be applicable, such as your authority limits or concerns related to other title matters. If any question has a “Yes” answer, your State Underwriting Department must be contacted for specific written approval bearing the signature of the State Underwriter in your file.

Contact: Please contact your local Underwriter with any questions.

Exhibit 1

Order No. _____

REO Sale Risk Assessment Checklist

(See NA-2014-006- Standard, "Post Foreclosure Underwriting: One-to-Four Family Reo Properties")

Possession

1. Is the Property Occupied by the Borrower, successor in interest to the Borrower or a tenant of Borrower? _____ Yes _____ No

Reverse Mortgages

2. If the foreclosed loan was a reverse mortgage on 1-4 family residential property, was the foreclosure commenced after the death of the borrower AND was the borrower survived by a spouse who could have been living in the property? _____ Yes _____ No

Equity

3. Does the purchase price (Amount of Insurance) exceed the amount of overall debt encumbering the property at the time of foreclosure? (If the amount is unclear from looking at the documents of record and/or the foreclosure documents, inquiry should be made of the REO seller as to the amount owed). If the excess of the current purchase price and the prior encumbrances can be accounted for by a change in the market value since the foreclosure sale – through improved market conditions and/or by documented improvements to the property post-foreclosure, mark this question as "No"; if you are not sure, mark it as "Yes". _____ Yes _____ No

Section 547 of the Bankruptcy Code

4. Is the current transaction within 90 days of the foreclosure sale <u>AND</u> the current purchase price is more than the bid amount at the foreclosure sale? _____ Yes _____ No

Foreclosure Defects

5. Are there reasons to believe that there are defects in the foreclosure or that someone will assert that there were defects in the foreclosure, including: _____ Yes _____ No

   a. To the extent of your customary review of foreclosure related documentation, were there any defects in the foreclosure process leading to the foreclosure judgment or sale by which title was acquired by the lender?
   b. Are there defects in the foreclosure process which may not have appeared in your customary review, but of which you became aware from other sources, including the seller/lender?
   c. Is there litigation alleging defects in the foreclosure, either pending or threatened?

Facts that might affect Defenses of the New Insured

6. Is there any evidence or indication that the present transaction fails to be an arm's length transaction between unaffiliated parties? _____ Yes _____ No

*If the answers to **all** of the questions above are "No," you are authorized, subject to any other risk limitations that may be applicable, to issue the policy. Sign and date this Checklist and maintain it in your file.*

_____

Signature

Name of signer:_____ Date:_____

Title:

If the answer to any question above is "Yes," you must contact your State Underwriting Department for written approval (see below).

(Please include the following information when submitting for approval)

Property Address: _____

[legally described as set forth in the preliminary report or commitment for title insurance issued under the Order Number referenced above (the "Property")]

Name of Foreclosing Lender: _____

Name of Servicer: _____

Amount of debt owed Foreclosing Lender at foreclosure _____

Amount of overall debt encumbering the property at time of foreclosure _____

Amount bid at the sale _____

Name of Seller (if different from Lender): _____

Name of Purchaser: _____

New Owner's Policy Amount: _____

New Loan Policy Amount (if applicable): _____

Signature of State Underwriter required below if form contains any "Yes" answers

Approved:_____Yes_____No

Basis for Approval (Must be completed by State Underwriter):

_____

_____

_____

Date:

First American Title Insurance Company

By: _____

Title:

Exhibit 2

Order No. _____

REO Sale Risk Assessment Checklist

(See NA-2014-006- Standard, "Post Foreclosure Underwriting: One-to-Four Family Reo Properties")

Possession

1. Is the Property Occupied by the Borrower, successor in interest to the Borrower or a tenant of Borrower? _____ Yes _____ No

   Comment: This is the single most important underwriting risk! If the borrower or someone claiming through the borrower is still in possession of the property, the risk that an issue concerning the validity of the foreclosure will be raised goes up exponentially.

Reverse Mortgages

2. If the foreclosed loan was a reverse mortgage on 1-4 family residential property, was the foreclosure commenced after the death of the borrower AND was the borrower survived by a spouse who could have been living in the property? _____ Yes _____ No

   Comment: Federal statutes provide that HUD must take steps to protect the rights of the borrower in a "reverse" mortgage while the borrower is still alive. The statutes also include the actual borrower's spouse in the definition of "borrower". In the past, HUD's regulations did not contain provisions for protecting the non-borrowing spouse, and challenges to the foreclosure were raised. Although current versions of the regulations now provide some protection for the non-borrowing spouse, if the foreclosure was triggered by the death of the borrower, and the borrower is survived by a spouse, the federal statute would protect the right of that spouse to continue to live on the property.

Equity

3. Does the purchase price (Amount of Insurance) exceed the amount of overall debt encumbering the property at the time of foreclosure? (If the amount is unclear from looking at the documents of record and/or the foreclosure documents, inquiry should be made of the REO seller as to the amount owed). If the excess of the current purchase price and the prior encumbrances can be accounted for by a change in the market value since the foreclosure sale – through improved market conditions and/or by documented improvements to the property post-foreclosure, mark this question as "No"; if you are not sure, mark it as "Yes". _____ Yes _____ No

   Comment: Equity, or value in the property that might be available to the borrower is the second leading indicia of risk. The greater the equity, or value in the property that would be available to the borrower if the property were sold, the greater the likelihood that the foreclosure will be challenged to access that equity.

Section 547 of the Bankruptcy Code

4. Is the current transaction within 90 days of the foreclosure sale AND the current purchase price is more than the bid amount at the foreclosure sale? _____ Yes _____ No

Comment: Section 547 of the Bankruptcy Code gives an "avoidance power" to the trustee to set aside certain types of transactions if they occur within 90 days of the debtor's filing bankruptcy. This "power" can be triggered if the debtor files bankruptcy within 90 days after foreclosure and the amount bid at the sale was less than the value of the property. The theory is that this difference between the amount bid, and the value of the property is equity that should go to the bankruptcy trustee to be used for the benefit of all creditors, not just the lender.

Foreclosure Defects

5. Are there reasons to believe that there are defects in the foreclosure or that someone will assert that there were defects in the foreclosure, including: _____ Yes _____ No

   a. To the extent of your customary review of foreclosure related documentation, were there any defects in the foreclosure process leading to the foreclosure judgment or sale by which title was acquired by the lender?
   b. Are there defects in the foreclosure process which may not have appeared in your customary review, but of which you became aware from other sources, including the seller/lender?
   c. Is there litigation alleging defects in the foreclosure, either pending or threatened?

Comment: A defect may give the borrower and/or property occupant tools to contest the foreclosure, raising policy defense issues and costs, whether that challenge is later defeated or not. There is a "Yes/No" blank next to this general criterion and before the specific Items listed below so that one understands that any defect in the foreclosure process, and not just the matters elucidated above, are considered important. If you are aware of a foreclosure issue that might not fit within the context of these subsequent matters, this question should be marked "Yes", even if the following specific questions could be answered "No".

Facts that might affect Defenses of the New Insured

6. Is there any evidence or indication that the present transaction fails to be an arm's length transaction between unaffiliated parties? _____ Yes _____ No

Comment: If the present transaction fails in this regard, defenses that might be available to defend the insured may not be present and could affect the risk analysis to issue a policy.

*If the answers to **all** of the questions above are "No," you are authorized, subject to any other risk limitations that may be applicable, to issue the policy. Sign and date this Checklist and maintain it in your file.*

_____

Signature

Name of signer:_____ Date:_____

Title:

If the answer to any question above is "Yes," you must contact your State Underwriting Department for written approval (see below).

(Please include the following information when submitting for approval)

Property Address: _____

[legally described as set forth in the preliminary report or commitment for title insurance issued under the Order Number referenced above (the "Property")]

Name of Foreclosing Lender: _____

Name of Servicer: _____

Amount of debt owed Foreclosing Lender at foreclosure _____

Amount of overall debt encumbering the property at time of foreclosure _____

Amount bid at the sale _____

Name of Seller (if different from Lender): _____

Name of Purchaser: _____

New Owner's Policy Amount: _____

New Loan Policy Amount (if applicable): _____

Signature of State Underwriter required below if form contains any "Yes" answers

Approved:_____Yes_____No

Basis for Approval (Must be completed by State Underwriter):

_____

_____

_____

Date:

First American Title Insurance Company

By: _____

Title: