White Paper:

FOUR WAYS TO USE PROPERTY RECORDS TO UNCOVER HIDDEN RISKS

By Michael O'Connell

Mortgage lenders and servicers who operate in the secondary market are familiar with the documentation requirements to ensure smooth transitions of their assets into that market but often overlook a critical element: property records.

This paper is designed to give step-by-step guidance on how to use property records to ensure a clear title conveyance and reduce the risk of buyback or inability to foreclose.

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Mortgage lenders and servicers who operate in the secondary market are familiar with the documentation requirements to ensure smooth transitions of their assets into that market. Most due diligence reviews typically address credit history, property valuations, ability to repay, and legal and regulatory compliance— all extremely important — but often overlook a critical element: property records.

As a recent paper by Duke University stated, "A $13 trillion residential mortgage market depends directly on clarity of mortgage title."[1] As a part of every loan transfer, each loan should undergo a thorough review of what is on land records in order to ensure there are no problems with the beneficial chain.

This paper is designed to give step-by-step guidance on how to use property records to ensure a clear title conveyance and reduce the risk of buyback or inability to foreclose.

Here are the top four ways to use property reports to uncover hidden risks:

1. Verify land record source documents

One of the major issues that can roadblock loan servicing transfers is faulty source documentation. Between the loan origination and the current sale there is ample opportunity for breaks in the beneficial chain.

This may not turn up during inspection of the file for a number of reasons. For example, physical files may have additional documents that never made it to the imaged file. The most common example is when a loan was in and out of default and attorneys prepared and potentially recorded assignments but never brought it to the servicer's attention.

Only a thorough inspection of the recorded documents in county land records can ensure what is actually on record in order to process a transfer seamlessly. But once the inspection occurs, it's also important to verify the integrity of these documents.

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For a document to be valid, it must accurately reflect the transfer of ownership from one entity to another, and it must correctly reference the recorded security instrument in every way. The assignor and assignee data must be precise; written exactly as the entities are listed as a registered company. Even missing a simple "Inc." can potentially change the beneficial rights of a loan, sometimes to a nonexistent entity.

As an example, Servicer A is selling loan servicing to Servicer B. Servicer B's official title is "Servicer B Servicing, Inc." but the recorded document is recorded to "Servicer B" and the "Inc." is omitted. Although this may seem minor, we have seen examples where this has caused the necessity for expensive corrective action and could potentially hold up a foreclosure if challenged.

Another example would be that the loan is originated in the name of "Company A", which then changed its name to (or merged with) "Company B". The assignment is then incorrectly created from "Company B" (assignor) to the new buyer (assignee), with no reference as to how "Company A" was acquired by "Company B". This creates a virtual break in the chain of beneficial rights just by "Company B" simply omitting the "FKA" or "SBM" reference to "Company A",(e,g, Company B formerly known as Company A).

Too many foreclosures have been held up for extensive periods of time as a result of incorrectly prepared documents stemming from prior incomplete or inaccurate source documents being used to prepare the document, or a lack of understanding of how to create assignments that properly keep chains intact. That's why it's vital during the transfer of any loan to verify there are no breaks in the chain of ownership and understand the potential implications of seemingly minor details.

- Every document in the report should provide notice to the public at large, and thus the property report describes all the enforceable claims against the property in question. It comes directly from the source.
- There is only one source. Property reports compiled from databases are unlikely to rise above the standard of being "almost right" (other than title plants directly mirroring public records with complete indexing and images.)
- The only source of universally enforceable rights to mortgages comes from the public record. Sometimes unrecorded documents placed in the collateral files are also used as verification of beneficial rights, but these can be as big a problem if the documentation used to prepare them was flawed or missing data to begin with. The presence of a document in the file that will not stand up to scrutiny is as bad as no document to begin with.

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2. Order an assignment verification report on any seasoned loan with a less-than-certain history.

There is no certainty that an assignment involving a seasoned loan, for servicing rights or securitization, may not be affected by a previous incorrectly prepared assignment. A badly prepared assignment or incorrectly assigned loan may result in nothing more than a cloud on title and certainly not the transfer of beneficial rights.

Seasoned loans can have multiple issues that can affect the ownership of beneficial rights. Here's just one example:

- A loan is originated with MERS as nominee for a bank or other institution.
- The loan then goes into default and pre-foreclosure and assigned out of MERS back to the servicer or investor.
- The loan is reinstated as current and taken out of foreclosure, but the MERS assignment never makes it to the servicer's attention.
- The loan is transferred again, and another assignment is prepared from MERS to the trust, or to the new servicer in cases of a servicing sale.
- This results in cloud on title and is an expensive error to correct, sometimes not being discovered until much later after the beneficiary is no longer in business, making a preparation of a new assignment almost impossible.

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The solution is to order an Assignment Verification Report (AVR) on *any* seasoned loan with a less-than-certain history. The AVR lists the exact chain of assignments, ensuring that any new assignment is prepared from the correct beneficiary. Of course, it's also essential that the assignment is prepared by a company that understands the details of the requirements and guidelines — making it their responsibility to ensure the assignment chain is intact according to agency guidelines.

An AVR is simply a true account of what is recorded at the county that identifies the current owner of a lien actually filed on a property. Any inaccuracies or breaks in chain are found and listed on the report.

Typically, attorneys prepare assignments to the foreclosing entity from information in the collateral files supplied by the servicer along with title reports. If the files were deficient or didn't match what was on record at the county, it could create a problem.

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Of course property reports are used regularly to verify the current beneficiary, but quite often they are flawed or the incorrect report is ordered to begin with. Most property reports do not index the chain of assignments and certainly do not list the flaws within the assignment body itself — flaws that make subsequent assignments invalid in some states.

A truly validated AVR is the perfect bridge between what is in servicers/custodial reports and what is actually on record at the county. You need reliable reports that identify if there is a gap or cloud on the assignment chain at the county and just as importantly, verification that the information within the body of the assignments on record effectively transfer the beneficial rights of the servicer or investor or not. Note: Some firms now offer AVRs from automated databases, and these are not recommended if you need to know with accuracy what is on land records.

3. Leverage a new mortgage verification report for new loans

A new mortgage verification report is a search of land records to verify the recorded position of a specific mortgage. The report should list any other open mortgages and subordinations, as applicable. The report should note if the subject mortgage has been released and provide a copy of the recorded release, if it is available.

Mortgage lenders, servicers and investors use this report to confirm their lien position shortly after loan origination. This is particularly helpful on refinanced loans. Refinanced loans typically have more issues relating to lien position due to recording errors or missing documents, such as subordinations or releases on prior liens. This type of report should be targeted and specialized, saving lenders and servicers the cost of an extensive report that has more information than they need.

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This report should help mortgage lenders and servicers to proactively uncover lien position issues early in the life of the loan, and ensure they have the mortgage position they expect. Some of the lien position issues that can be identified with this report are:

- Prior lenders that were not paid in full with an unreleased mortgage still on the property or prior lenders that failed to file a required release.

- Subordinations that were not obtained or recorded, thereby causing a second mortgage or home equity loan to be in first position.

- Potential fraud with multiple mortgages on record at the same time.

There is a substantial benefit to ordering this report for newly originated loans that have been designated as a part of a loan transfer. This will help identify, up front, any outstanding defects that could prevent selling the mortgage(s) at a premium or cause difficulty to foreclose later on. Defects can thereby be resolved proactively, while they are new, rather than uncovering problems years later when it is difficult, or even impossible to resolve.

4. Be watchful for original unrecorded assignments in collateral files

Relying solely on the contents of what was in a collateral file can be misleading. Collateral files commonly have old, unrecorded, fully executed original assignments in the file that can appear to resolve a missing assignment issue. However, if you blindly recorded this document, you might actually cloud the title by complicating an assignment chain or recording an erroneous assignment without realizing it.

You should first verify what assignments were actually recorded at the county to determine if the unrecorded assignment from the collateral file is necessary, and also to determine what specific assignments are missing, if any. During our reviews, we very often find that the assignment in the file was already recorded, or something entirely different is on record. We've learned you can never be entirely sure unless you check first. If you discover an accurately prepared, fully executed assignment that cures an assignment chain issue, more often than not it is actually useable and enforceable so it is not always wrong. It is a best practice to check first.

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However, unrecorded "Assignments to Blank" in the files is a whole other matter for discussion. There has been a longtime industry practice of preparing an assignment but leaving the spot for the *assignee* blank with the purpose of filling it in later and then filing the assignment in the collateral file for later use. There is a tremendous amount of discussion in the industry surrounding this issue and our opinion is that this practice should be eliminated completely.

The legality is highly questionable of "filling in" the assignee and modifying documents that have already been executed and notarized. A best practice is to always accurately prepare and record assignments in the county at the time of the transfer. This is important to preserve our land records and accurately reflect the assignment chain. Leaving the assignee blank and storing them is a practice that will most certainly be viewed negatively by regulators.

In Conclusion

Clouded titles are a serious impediment to the secondary mortgage market. With years of unrecorded assignments of mortgage at the county level, due diligence in this area is critical.

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By verifying the land record source documents, lenders and servicers can ensure that there are no breaks in the chain of ownership to trip up the transfer process. Ordering an AVR on any seasoned loan will address the multiple issues that could arise from improper assignments in the loan's past. Leveraging a new mortgage verification report with refinanced loans in the early stages of origination can save both time and money, as resolving those issues usually will only get harder on the back end. And checking for original unrecorded assignments in collateral files will keep your transfer clear of any problems associated with "Assignment to Blank" documents.

Tracking a loan's history through source documents and making sure it has an enforceable chain of ownership is more crucial than ever in today's regulatory environment. Taking these four actions to uncover the risk that is often hidden will smooth the way for successful loan transfer.

1. Levitin, Adam. *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, Duke University , 2013.