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Mortgage Wrap ("Wrap") FAQs

What is a wrap? A mortgage wrap transaction is simply the seller financing of a property that does not pay off the current mortgage lien on the property. The property is conveyed and the existing mortgage lien stays in place with a second, junior lien held by the seller.

Is a wrap illegal? A wrap is not illegal. A wrap transaction is also not a breach of contract nor a "violation" of the due-on-sale clause. The traditional language used for the due on sale clause most usually does not prohibit a transfer of property without the lender's consent. The clause commonly indicates that if the borrower transfers the property without the lender's permission then the lender may opt to declare the loan due. As discussed more fully below, the language is not prohibitory in nature.

Is a wrap the same as an assumption? No. In an assumption, the buyer is authorized to assume the legal responsibility and obligations of the existing first-lien note. This may or may not be accomplished with the approval of the seller's lender and paying an assumption fee. The assumption documents expressly state that the buyer is taking on the legal obligation of paying the first-lien note. In a wrap transaction, the first-lien note remains the exclusive responsibility of the seller. After a wrap transaction, there are two separate and independent sets of payment obligations. The buyer becomes obligated to the seller on the new wrapped note, which is secured by a mortgage wrap deed of trust; and the seller remains obligated on the first-lien/wrapped note until it is paid and released.

What is an "all-inclusive deed of trust"? This is another name for a wrap around mortgage.

What is a "subject to" purchase? This is a purchase by a buyer in which the seller is not to receive any future payments from the purchase. The buyer conveys full payment (usually less than the equity in the property) and the seller loan remains in place with the payments to be issued by the buyer directly to the lender.

How is a wrap different from a lease/purchase option? In a wrap, the buyer is the legal owner of the property. In a Lease/Purchase Option, the seller remains the owner until the buyer executes upon his option to purchase the property. Additionally, in Texas, a Lease/Purchase Option longer than 180 days is governed by Title 2, Chapter 5, Sub-Chapter D of the Texas Property Code and the seller must comply with very strict and sometimes onerous terms.

What is a "Due on Sale" clause? Most real estate loans will have a contract term in the loan documents in which the borrower agrees to not convey the collateralized property without either issuing payment in full for the amount due on the loan or obtaining authority from the lender to convey the property.

The language used in the Fannie Mae/Freddie Mac Uniform Deed of Trust is as follows:

> If all or any part of the Property or any interest in the Property is sold or transferred (or if Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred) without Lender's prior written consent, Lender may require immediate payment in full of all sums secured by this Security Instrument.

This is not prohibitory language. It says the lender may accelerate the note if it wants to. When an owner transfers a property without consent from the lender, the owner makes it possible for the lender, if the lender so chooses, to accelerate the note. It is not a breach of the deed of trust. It is not fraud.

Will the lender call the loan due? Each buyer and seller in a wrap transaction will have to reach their own conclusion as to whether a lender, in the current economic environment, would call a note due and foreclose, when payments continue to be issued and the property remains properly insured.

Phil Grove of Austin Texas who has conducted hundreds of mortgage wraps states "a lender calling a performing note due because of a breach of the due on sale clause is like the Loch Ness monster…you hear a lot about it but no one has ever seen one". However, it must be stated that it remains theoretically possible that a lender could call the note due. The lender may not like the fact that the property has been conveyed; but, as long as payments continue on a timely basis, the risk that a lender will do anything about it is small.

Should the parties purchase title insurance? Unequivocally, the answer is Yes. A wrap transaction does not interfere with the insurability of title in the name of the buyer, therefore an owner's policy of title insurance is available and the parties to a real estate transaction are encouraged to purchase this coverage.

Are the parties required to purchase title insurance? No. Title insurance is not legally required in a wrap transaction. Many transactions are closed in a lawyer's office without title insurance, on the basis of an informal title search or a title report.

The purchase and issuance of title insurance is to be negotiated and agreed upon by the buyer and seller. If title insurance is issued, any claims in relation to the underlying mortgage on the property are excluded from coverage.

What is the Annual Percentage Rate (APR) for a wrap promissory note? The parties can negotiate and agree upon any APR that is not illegal under the applicable state and federal lending regulations.

What should the down payment amount be in a wrap transaction? The parties can negotiate and agree upon any down payment amount. The parties will need to provide sufficient funds to issue payments for real estate commissions, closing costs and any down payment amount desired by the seller.

Additionally, this is an underwriting issue. The seller, like any lender, should carefully consider the risks inherent in the transaction as well as the creditworthiness of the borrower before determining the amount of the down. If the down payment is not sufficient, this increases the risk of the seller loan.

Who provides Home Owner's Insurance for the property? There is a great deal of incorrect and/or bad advice commonly given in regards to this subject such as (1) the seller should maintain insurance (2) both the buyer and seller should have insurance, (3) the buyer should purchase a renter's policy, etc. All of this is incorrect and each one poses a risk to both parties. Technically, the experts advise that the seller should terminate his or her insurance policy on the property since he/she is no longer the legal owner on title, the seller is no longer an owner-occupant (as required by a homeowner's policy), and he/she no longer has an "insurable interest" in the property. This can pose potential future issues with the current insurance contract and insurance carrier. The new buyer should purchase a new homeowner's policy in his or her name to cover the buyer's liability, personal belongings, and interest in the property and list the seller and underlying lender as mortgagees.

If the seller simply terminates the insurance and no other proof of coverage is provided, the original lender will purchase "force-placed" insurance at a greatly increased price and pass this cost to the seller by adding the amount to the balance of the existing loan. In addition, the buyer will not have any coverage for his or her personal property, liability, or interest in the property itself.

Therefore, all buyers and sellers in a wrap transaction are encouraged to speak with an experienced homeowner's insurance broker for guidance in this area. Two experts with a great deal of personal experience in seller-financing and wrap-mortgagesand who specializein this area exclusively are:

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Mike Monzingo
Texas Independent Insurance
1420 W. Exchange Pkwy Ste 130
Allen, TX 75013
Phone: (972)-612-2393
Mike@knowyouragent.com

Ben Archer
State Farm Insurance Agent
Address: 12117 Bee Caves Rd
Bee Cave, TX 78738
Phone: (512) 263-5565
ben.archer.poco@statefarm.com

Regardless of which expert is sought, I would suggest all seek the advice of an expert in this area before making any insurance decisions.

When does a wrap loan end? The wrap loan will end either by its terms or when the property is sold or refinanced. Upon the sale or refinance, the underlying/original mortgage is paid off and the remaining dollars go to the wrap lender.

Who owns the property after a wrap transaction? The seller will execute a warranty deed conveying the property to the buyer. This warranty deed is filed in the property records for the county in which the property resides. The buyer is the legal owner of the property with the seller maintaining similar rights of redemption as a traditional mortgage lender.

Who pays the taxes on the property after a wrap transaction? The buyer is legally responsible for all taxes once the warranty deed is filed indicating the buyer is the legal owner of the property. The buyer also receives the tax advantage of being able to write off interest payments on the loan. The property taxes can be paid via a servicing company as in traditional mortgage lending (see further information below).

Who gets the interest deduction? The seller continues to be able to deduct interest paid on the wrapped loan. Nothing has changed there. As to interest on the wrapped note, interest received by the seller must be reported as income, and interest paid by the buyer is deductible. More details must be obtained from your tax advisor. The Law Offices of T. Alan Ceshker cannot provide tax advice.

What happens if the buyer defaults on the wrap loan? If the buyer fails to issue payments under the terms of the wrap promissory note, the seller will need to pursue non-judicial foreclosure under the terms of the deed of trust and the applicable foreclosure laws. The seller remains responsible for the existing mortgage until it is paid off in full.

Texas laws regarding foreclosure are very favorable to the lender. Property Code Sec. 51.002 requires that a homeowner be given at least a 20 day notice of default and intent to accelerate the note if the default is not timely cured. If the deed of trust is on a FNMA form, then a 30 day notice and opportunity to cure is required.

Then, the default notice must be followed by a second letter stating that since the default was not cured, the note is accelerated and the property is being posted for foreclosure. This second notice must be given at least 21 days before the first Tuesday of the month in which the foreclosure will be held. Thus a Texas foreclosure can take as few as 41 days to complete a foreclosure. If the deed of trust is on a FNMA form, the foreclosure can take as few as 51 days.

The Seller can also seek and obtain a deficiency judgment if the sales price at foreclosure is insufficient to discharge the wrap note plus accrued interest and fees. The seller thus has the same ability to enforce his note and lien as does any other lender.

After foreclosure, the former owner may still refuse to leave and eviction may be necessary. Again, Texas law is favorable for the foreclosing lender/owner. The owner must give a 3 day notice to vacate, file a petition in justice court, get it served, get it heard by the Justice of the Peace, and then wait 5 days for a final judgment and a writ of possession. One must then wait until the constable posts a 48 hour notice on the door and then forcibly removes occupants who are otherwise unwilling to leave. The process can be accomplished is about 3 weeks, although an appeal to county court can lengthen this process significantly. Further information regarding the eviction process can be obtained from the Law Offices of T. Alan Ceshker.

What if the original lender learns of the conveyance of the property? The lender would have the right under the terms of the loan agreement to accelerate the note and call the funds due for full payoff. At this point, the buyer would either need to negotiate an assumption of the mortgage or get a new loan to pay off the original loan.

What if the seller does not issue payment to the existing mortgage lender? / What if the buyer does not issue a payment to the seller? / What if the buyer does not pay taxes? / How does the seller calculate the payoff amount when the property is refinanced? All of these questions (and others) can be answered by utilizing a loan servicing company in the same manner as conventional mortgages. A loan servicing company will issue late notices, issue acceleration notices, escrow funds for taxes and insurance, issue payments for property tax and insurance, receive payments from the buyer, issue payments to the existing lender, etc. All of the functions of a traditional loan servicing company are provided to seller finance/wrap transactions.

Therefore, all buyers and sellers in a wrap transaction are encouraged to speak with an experienced loan servicing company for guidance in this area. One expert with a great deal of personal experience in seller-financing and wrap-mortgages and who specializes in this area exclusively is Dan Francis. His phone number is *512-731-4541* and the email address is Admin@safeloanservicing.com. Regardless of which expert is sought, I would suggest all seek the advice of an expert in this area before making any loan servicing decisions.

Additionally, the wrap agreement provides that if the seller fails to make payments to the wrapped lender the buyer may do so and receive credit against the wrapped note. The buyer should retain the authority to request documentary proof from the underlying lender that the wrapped note is current.

What happens if the seller files bankruptcy/dies? In both cases, the buyer could be forced to refinance the debt on short notice. In the case of bankruptcy, the seller should agree in the wrap agreement to execute a reaffirmation agreement on the wrapped debt (i.e., rather than seeking to discharge it in the bankruptcy). As for the death of the seller, the only solutions would be 1) term life protection (payoff insurance) for the seller, or 2) the buyer can obtain a term life insurance policy on the seller in the amount of the balance on the wrapped debt.

What are the advantages of a wrap? In a situation where a buyer cannot obtain traditional financing, a wrap transaction allows them to achieve the benefits of home ownership.

The seller is also able to garner more interest and potential buyers by offering their property for sale as "seller financing"

What are the disadvantages of a wrap? The seller has to wait until the wrap note balloons in order to receive the full proceeds of the sale. Additionally, the underlying wrapped loan will remain on the seller's credit reporting. Also, the underlying loan is almost always locked in place and cannot be refinanced or modified by the seller for the duration of the wrap. If the seller finance/wrap borrower defaults, the seller must foreclose, which is not usually a problem with Texas' favorable foreclosure laws. In the very unlikely event a loan is accelerated, the buyer may have to secure traditional financing. The parties may also be carrying duplicate casualty insurance policies.

Who drafts the documents for a wrap transaction? A properly drafted wrap transaction will include a warranty deed, deed of trust, promissory note, a wrap agreement/contract and several disclosure documents. These are complex documents that are customized for each particular transaction. Only a qualified real estate attorney experienced in preparing wrap documents should be used to draft these papers. There are no adequate forms available from the Texas State Bar or TREC. Additionally, the TREC earnest money contract should include an attorney-prepared wrap addendum. A sample of such an addendum is available at www.ceshkergroup.com.

What are the fees for a wrap transaction? The parties will need to provide sufficient funds to issue payments for real estate commissions, closing costs and any down payment amount desired by the seller. The legal fees including the lien search fees, recording fees, courier fees, party consultation with attorney and attorney's fees for document preparation are based on the size and complexity of the transaction. These fees will range from $1,500.00 to $2,500.00.

The information forms to begin the process are available at

http://www.ceshkergroup.com/docs/WrapInformationForm-Buyer.pdf and

http://www.ceshkergroup.com/docs/WrapInformationForm-Seller.pdf

What if there are insufficient funds to pay realtor fees? If the realtors agree, the commissions can be paid monthly via the payments issued by the buyer. The loan servicing company can issue the realtors' funds along with the existing mortgage payment, taxes, insurance, etc.

What happens after the wrap transaction? The buyer will need to prepare to refinance or sell the property before the wrap promissory note matures. If the note matures and the buyer is not in a position to refinance or sell the property, the seller will have a right to redeem the property.

What if the buyer cannot refinance by the maturity date? The buyer needs to ensure that the reason for not being able to obtain traditional financing is resolved before the maturity date. If not, the seller may not allow an extension and could foreclose on the property for not paying off the loan on or before the maturity date.

What is the SAFE Act? The SAFE Act places a licensing requirement on certain types of owner financing extended by persons regularly engaged in selling owner-financed residences. This Act applies to wrap transactions. However, the seller is not required to be licensed if the property is the seller's homestead and/or the sale is to a family member. So, if the subject property is an investment rental house being sold to a non-family member, the transaction and the parties are subject to the

SAFE Act and the seller is required to have a residential mortgage loan origination license from the Texas Department of Savings and Mortgage Lending. The licensing rule applies only to residential wraps.

However, the Texas Department of Savings and Mortgage Lending has ruled that the SAFE Act does not apply to persons who make five or fewer owner-financed loans in a year (a de minimus exemption under Finance Code Sec. 156.202(a)(3)).

What is the Dodd-Frank Bill? The Dodd-Frank Bill overlaps the SAFE Act in its regulatory effect. This law provides for a de minimus exception for persons doing three or less owner financed transactions per year. However, there is no exception from the requirement that a seller/lender in a Wrap transaction determine at the time credit is extended that the buyer/borrower has the ability to repay the loan. Seller is obligated to investigate Buyer's credit history, current and expected income, current obligations, debt-to-income ratio, employment status, etc. in order to make this determination. Additionally, the loan must be fully amortizing (i.e., there is no balloon). Lastly, the owner financed note must have a fixed rate or, if adjustable, must adjust only after five or more years and be subject to reasonable annual and lifetime limitations on interest rate increases.

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T. Alan Ceshker, Attorney at Law
http://www.ceshkergroup.com

13413 Galleria Circle Suite 120 Austin, Texas 78738
P (512) 961-7848 F (512) 961-7849