D R A F T

FOR DISCUSSION ONLY

Mortgage Modifications Act

Uniform Law Commission

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Mortgage Modifications Act

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Prefatory Note

I. Purpose of the Act

The Mortgage Modifications Act resolves problems and uncertainty in the law governing the modification of mortgage loans and other obligations secured by a mortgage. Current law is not clear, leading to unnecessary expense and delay in loan modifications and in some cases to foreclosures that could have been avoided by a modification. The purpose of the act is to save time and expense for borrowers and lenders and to facilitate agreed upon loan modifications to avoid foreclosure. The act benefits both homeowners and commercial borrowers in distress by making it easier to modify a loan as an alternative to foreclosure.

II. Why the Act Is Needed

The parties to a mortgage often agree to modify the terms of the mortgage loan or other obligation secured by the mortgage after the initial transaction is completed. Typical modifications include extending the maturity date of a loan, changing the interest rate or the method by which interest is calculated, increasing the loan amount by agreeing to additional advances, capitalizing unpaid interest, modifying escrow or insurance requirements, modifying disbursement conditions, and modifying financial covenants. A mortgage modification is not a grant of a new consensual interest in real property to secure an obligation but rather modifies an existing mortgage or related agreements.

The reasons for modifying secured obligations vary. A lender may agree to modify a loan in response to a borrower's default in payment or the borrower's financial distress. Some commercial credit facilities are modified on a periodic basis to reflect changing conditions in debt markets or to substitute debt tranches.

The common law is not clear on the issue of whether the modification of a mortgage loan or other obligation secured by a mortgage affects the priority of the mortgage as against junior interest holders, such as a junior lienholder. In addition, confusion exists as to whether a mortgage modification agreement should be recorded in order to maintain mortgage priority. Finally, cases hold that if a modification constitutes a novation of an obligation secured by a mortgage, the mortgage no longer secures that obligation.

This lack of clarity in the law causes delay and unnecessary expense for borrowers and in some cases may mean that a loan is foreclosed rather than modified. In commercial transactions, attorneys are reluctant to issue unqualified opinion letters for modifications. Even with modifications that only change the terms of the debt, borrowers may be required to pay for recording a modification agreement, for a title update to confirm that there are no intervening liens, for a title insurance endorsement, or for a qualified opinion letter. For residential borrowers in distress, obtaining the acknowledgment required for a modification agreement to be recorded may prove difficult. Furthermore, a junior lienholder may obstruct an attempted modification even when the modification will not prejudice the junior lienholder.

III. Typical Provisions of Mortgages and Modification Agreements

The Mortgage Modifications Act does not operate in a vacuum. It operates on mortgages and on modification agreements that typically contain several relevant provisions.

First, a well-drafted mortgage will contain a provision to the effect that the mortgage secures all modifications, amendments, extensions, and restatements of the loan.

Second, most commercial mortgages contain a due-on-encumbrance clause, which provides that the lender may accelerate the loan if the collateral is encumbered without the consent of the lender. A commercial mortgage may also contain a covenant by the borrower not to further encumber the mortgaged property without the lender's consent. If the holder of a senior mortgage agrees to a junior ~~lien~~mortgage, the parties will generally enter into an intercreditor agreement defining their respective rights and obligations with respect to the collateral and the loans~~.~~, and the act does not affect an intercreditor agreement that dictates priority as between the parties thereto. Residential mortgages generally do not contain a due-on-encumbrance clause because the Garn-St. Germain Act, 12 U.S.C. 1701j-3, prohibits the exercise of a due-on-encumbrance clause in a residential mortgage. Thus, residential borrowers may and often do obtain secondary financing such as a home equity loan.

Finally, a well-drafted mortgage loan modification agreement will contain a no-novation provision to the effect that the modification does not constitute a novation of the secured obligation or the mortgage.

The operation of the act does not depend on these provisions in a mortgage or loan modification agreement.

IV. Operation of the Act and Exclusions from the Act

The act creates safe harbor modifications of a mortgage loan or other transaction secured by a mortgage. For the listed modifications: (1) the mortgage continues to secure the obligation as modified; (2) the modification does not affect the priority of the mortgage; (3) the mortgage retains its priority regardless of whether a record of the modification is recorded in the public land records; and (4) the modifications are not so substantial as to constitute a novation. The types of modifications that are within the safe harbors are set forth in the act and described in reporter's notes. Included among the safe harbor modifications are the extension of the maturity of the loan, a decrease in the interest rate of the loan, capitalization of unpaid interest, changes to escrow or insurance provisions, modification of an existing condition to an advance of funds that was anticipated before the modification, and changes to financial covenants. The safe harbor modifications are ones that generally would not materially prejudice a junior interest holder.

Modifications outside of the safe harbors are governed by other law. An example of the type of modification that falls outside of the safe harbor is a new advance not contemplated by the original loan. Such an increase in the principal of the loan is not in the safe harbor because it would materially prejudice a junior lienholder. Cases hold that the senior lienholder loses priority to the extent of the increase. Another example is an increase in the interest rate of a loan because such an increase can materially prejudice a junior interest holder. Other modifications the fall outside of the safe harbor list may not prejudice a junior interest holder and thus under other law would not cause a loss of priority.

Some transactions are expressly excluded from the operation of the act and are also governed by other law. These include changes in the collateral, changes in the identity of a borrower or guarantor, and transfers of a loan.

The act removes roadblocks to modification by making the law more certain and by protecting the priority of a mortgage for specified modifications within the safe harbor. The act seeks to adopt the appropriate balance between the rights of the parties to a senior mortgage to modify loan terms and the rights of a junior interest holder to avoid material prejudice to its lien position. The act defines as a matter of statutory law certain modifications that will not be treated as materially prejudicial to junior interests. With greater clarity in the law, for many modifications, borrowers will avoid recording costs and costs of a title policy endorsement and of a legal opinion. In addition, by facilitating modifications, borrowers may be able to avoid a foreclosure.

NOTES TO COMMITTEE:

1. "Questions for the Committee" within the draft are not intended to be exhaustive, and we hope that the Committee will have many questions and comments of their own.

2. These brackets {} indicate a choice for the committee. Straight brackets [] indicate a choice for an enacting state.

3. The reporter, vice chairs, and chair will appreciate comments and suggestions from everyone on the roster about the entire draft; that is, the text of the act, prefatory note, and reporter's notes. We are looking for typographical errors, substantive errors, and inconsistencies between the text of the act and the prefatory note and the reporter's notes or comments.

4. As used in these notes and questions, "Committee" includes Commissioners, Advisors, Observers, and any others to whom this draft is distributed.

Mortgage Modification Act
(subject to Executive Committee's approval of Style Committee's change of title)

Section 1. Title

This [act] may be cited as the Mortgage Modification Act.

Section 2. Definitions

In this [act]:

(1) "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

(2) "Financial covenant" means a duty to ~~satisfy a test, or provide evidence, of~~ demonstrate an obligor's ~~continued~~ creditworthiness or adequacy ~~of the value~~ of security.

(3) "Modification" includes change, amendment, revision, correction, addition, supplementation, elimination, waiver, and restatement.

(4) "Mortgage" means a record that evidences a consensual interest in real property to secure payment or performance of an obligation regardless of how the record is denominated, including a mortgage, deed of trust, trust deed, security deed, indenture, or deed to secure debt. The term does not include a record that evidences a consensual interest to secure a ~~duty~~ liability owed by a unit owner to a condominium association, owners' association, or cooperative housing association for association dues, fees, or assessments. A record is a mortgage even if it also evidences a security interest in personal property.

(5) "Mortgage modification" means modification of:

(A) a mortgage; ~~or~~

(B) a record that evidences an obligation, including a promissory note, loan agreement, ~~or~~ credit agreement, or guaranty; or

(C) a record that evidences other security for an obligation, including an assignment of leases or rents~~; or~~.

~~(D) another record executed in connection with an obligation.~~

(6) "Obligation" means a debt or other duty or liability secured by a mortgage.

(7) "Obligor" means a person that:

(A) owes payment or performance of an obligation;

(B) signs a mortgage; or

(C) is or whose property is otherwise accountable in whole or in part for payment or performance of an obligation.

(8) "Person" means an individual, estate, business or nonprofit entity, public corporation, government or governmental subdivision, agency, or instrumentality, or other legal entity.

(9) "Record", used as a noun, means information:

(A) inscribed on a tangible medium; or

(B) stored in an electronic or other medium and retrievable in perceivable form.

(10) "Sign" means, with present intent to authenticate or adopt a record:

(A) execute or adopt a tangible symbol; or

(B) attach to or logically associate with the record an electronic symbol, sound, or process.

QUESTIONS FOR THE COMMITTEE:

1. Should the definition of "mortgage modification" be modification of "the terms" of the listed records rather than modification of the records?

2. Is the language "in whole or in part" necessary in subsection C of the definition of obligor? (The definition comes from the definition of obligor in the Home Mortgage Foreclosures Act.)

Reporter's Notes

1. **Electronic.** The definition of "electronic is the standard Uniform Law Commission definition.

2. **Financial Covenant.** Examples of financial covenants include requirements for a borrower to maintain a certain level of income or net worth, for maintenance of a certain loan-to-value ratio or debt service ratio, for furnishing financial records, for production of tax returns, and for maintenance of deposit accounts with the lender.

3. **Modification.** The term "modification" is broad and encompasses a change, amendment, revision, correction, addition, supplementation, elimination, waiver, or restatement. A modification may be made by any means of agreement or communication.

4. **Mortgage.** A "mortgage" is any record that evidences a consensual interest in real property to secure payment or performance of an obligation. Depending upon local usage and custom, a record that evidences a consensual interest in real property to secure payment or performance of an obligation may be denominated a mortgage, deed of trust, trust deed, security deed, indenture, deed to secure debt, or the like. An installment land contract, sometimes called a contract for deed, is included within the definition of a mortgage if under state law it creates or retains a consensual interest in real property to secure payment or performance of an obligation. A mortgage may also evidence a security interest in fixtures and personal property in addition to the real property that it encumbers, and in such a case, it is still a mortgage.

The definition excludes a record that evidences a consensual interest to secure an obligation owed by a unit owner to a condominium association, owners' association, or cooperative housing association for association dues, fees, or assessments because the act is not intended to apply to the modification of a declaration of covenants, conditions, and restrictions or other record that evidences an obligation owed by a unit owner to the association for association dues, fees, or assessments. A unit owner includes a homeowner, condominium owner, or cooperative unit owner/lessee who is a member of the association (or a shareholder in the case of a cooperative). The reason for the exclusion is that the modification of such a record does not raise the same types of issues raised by modifications of other consensual liens.

The definition of mortgage is based on definitions in recent real property acts such as the Uniform Home Foreclosure Procedures Act, the Model Negotiated Alternative to Foreclosure Act, and the Uniform Nonjudicial Foreclosure Act; however, the definition is tailored specifically for this act. Real property acts have not used a consistent definition for the term mortgage because the various acts need different definitions.

5. **Mortgage modification.** A "mortgage modification" is a modification of the terms of the mortgage itself or of a record that evidences~~, creates,~~ or secures obligations secured by the mortgage. The term includes the modification of a promissory note, loan agreement, credit agreement, ~~assignment of rents, and the like~~ guaranty, assignment of leases or rents, and the like. A change that is incorporated in the existing terms of mortgage or other record, such as a default interest rate or an agreed upon interest rate adjustment, is not a mortgage modification.

~~**QUESTIONS FOR THE COMMITTEE REGARDING THE DEFINITION OF “MORTGAGE MODIFICATION”:**~~

~~**1. Is the definition too broad in covering modification of any record executed in connection with an obligation? It would include modifications of a guaranty. I think the definition works because modifications other than those listed as part of the safe harbor are covered by other law.**~~

~~**2. If we keep subsection (D), do we need subsection (C)?**~~

~~**3. Should the definition be modification of “the terms” of the listed records rather than modification of the records?**~~

6. **Obligation.** An obligation as defined in the act is secured by a mortgage. The term includes a non-recourse debt, whether the debt is non-recourse due to the application of anti-deficiency judgment legislation, agreement of the parties, or for other reasons.

7. **Obligor.** This definition is based on the definition of the term in the Uniform Home Foreclosure Procedures Act. Subsection (a) covers the borrower or debtor; subsection (b) covers a mortgagor who is not the borrower or debtor; and subsection (c) covers a guarantor, including a guarantor whose obligation arises upon a condition, and a party who has pledged other property to secure an obligation.

8. **Person.** The definition of “person” is the standard Uniform Law Commission definition.

9. **Record.** The definition of “record”, used as a noun, is the standard Uniform Law Commission definition.

10. **Sign.** The definition of "sign” is the standard Uniform Law Commission definition.

Section 3. Scope

(a) Except as provided in subsections (b) and (c), this [act] applies to a mortgage modification.

(b) This [act] does not affect the following law of this state:

(1) law governing the required content of a mortgage;

(2) a statute of limitations or other statute governing the expiration or termination of the right to enforce an obligation or a mortgage;

(3) a recording statute;

(4) a statute governing the priority of a tax lien or other governmental lien; [or]

(5) except as provided in Section 4(b)(8), law governing the priority of future advances~~.~~[.][; or

(6) a statute requiring recordation of a mortgage modification.]

(c) This [act] does not affect:

(1) a release of, or addition to, ~~or other change to~~ property encumbered by a mortgage;

(2) a release of, addition of, or other change in ~~the identity of~~ an obligor; or

(3) an assignment or other transfer of an obligation.

Legislative Note: *Section 3(b)(6) should be omitted unless the state has a statute that requires recordation of a mortgage modification.*

Reporter's Notes

1. **Scope.** Except as provided in subsections (b) and (c), the act applies to a mortgage modification, defined as the modification of the terms of a mortgage or of a record that creates, evidences, or secures an obligation secured by a mortgage.

2. **Exclusions.** The act does not change or override certain laws of this state, and subsection (a) lists those laws. Subsection (b) lists modifications and transactions to which the act does not apply.

3. **Laws governing contents of a mortgage.** The act does not affect any state law that requires a mortgage to include certain terms, such as a statute that requires that a mortgage state the maximum principal of a loan.

4. **Statutes of limitations.** The act does not override statutes of limitations, statutes of repose, marketable title acts, or other statutes that govern the expiration of the right to enforce an obligation or a mortgage and that may depend upon the maturity date of a loan as stated in a recorded mortgage.

5. **Recording acts.** The act does not affect state recording acts.

6. **Statutes governing priority of governmental liens.** The act does not affect any state statute that dictates the priority of a tax lien or other governmental lien.

7. **Laws governing the priority of future advances.** The act does not override existing

law governing future advances except that a waiver or modification of an existing condition to an advance of funds is within the safe harbor as provided in section 4(b)(8).

8. ~~**Release of, addition, or change to collateral.** The act does not apply to a modification of a mortgage that releases, adds to, or changes the mortgaged property~~**Statute requiring recordation of a mortgage modification.** The state of Ohio has a statute that requires the recordation of a mortgage modification. A mortgage modification does not take effect until it is delivered to the recorder. Ohio Rev. Code Ann. § 5301.231. Ohio may be the only state with such a statute. Section 3(b)(6) may be omitted in states that do not have such a statute.

9. **Release of or addition to collateral.** The act does not apply to a modification of a mortgage that releases or adds to the mortgaged property.

10. **Release, addition, or change in ~~identity of~~ obligor.** The act does not apply to a release of, addition of, or other change in the identity of a borrower, mortgagor, guarantor, or other obligor.

~~10~~11. **Assignment of an obligation.** The act does not apply to the assignment or other transfer of a mortgage loan or other obligation secured by a mortgage. This section makes clear that these transfers are not covered by the act.

~~**QUESTION FOR THE COMMITTEE: Should we eliminate "the identity of" in Section 3(c)(2)?**~~

Section 4. Effect of Mortgage Modification

(a) For a mortgage modification described in subsection (b):

(1) the mortgage continues to secure the obligation as modified;

(2) the modification does not affect the priority of the mortgage;

(3) the mortgage retains its priority whether or not a record of the mortgage modification is recorded in the [public land records~~;~~]; and

(4) the modification is not a novation.

(b) Subsection (a) applies to:

(1) an extension of the maturity date of an obligation;

(2) a decrease in the interest rate of an obligation;

(3) a modification of the method of calculating interest that does not result in an increase in the interest rate as calculated on the date the modification becomes effective~~;~~,

including:

(A) a change in the index and margin based upon which interest is calculated, to a different nationally-recognized index and margin if the interest rate as modified is not higher than the former rate on the date the modification becomes effective;

(B) a change from a floating or adjustable rate to a fixed rate if the fixed rate is not higher than the floating or adjustable rate on the date the modification becomes effective;

(C) a change from a fixed rate to a floating or adjustable rate based on a nationally-recognized index if the interest rate as modified is not higher than the fixed rate on the date the modification becomes effective; and

(D) a temporary reduction in the interest rate with a subsequent increase sufficient to recoup no more than the interest lost due to the reduction;

(4) a capitalization of unpaid interest or other unpaid obligation;

(5) a forgiveness, forbearance, or other reduction of principal, accrued interest, or other monetary obligation;

(6) a modification of a requirement for maintaining an escrow or reserve account for payment of taxes, insurance premiums, or another obligation;

(7) a modification of a requirement for acquiring or maintaining insurance;

(8) a modification of an existing condition to advance funds;

(9) a modification of a financial covenant ~~of an obligor~~; and

(10) a modification of the payment amount or schedule resulting from another modification described in this subsection.

(c) The effect of a mortgage modification not described in subsection (b) is governed by other law.

Legislative Note: *Include the proper name for the public land records in section 4(a)(3).*

QUESTION FOR THE COMMITTEE: Does the list in section 4(b)(3) belong in the blackletter or in comments?

Reporter's Notes

1. **Applicability.** Section 4 applies to a modification of the terms of a mortgage or of a record that evidences or secures an obligation, including modification of a promissory note, loan agreement, credit agreement, assignment of rents, or other record executed in connection with an obligation secured by a mortgage. The provisions of subsection (a) apply to modifications that are within the list in subsection (b) of safe harbor modifications. Other law governs modifications that are not within the list.

2. **Security.** Most mortgages state explicitly that the mortgage continues to secure obligations as modified. For modifications within the safe harbor, the mortgage continues to secure obligations as modified even without such a provision, and modifications within the safe harbor are not a novation.

3. **Priority.** The act creates a safe harbor for modifications that will not cause the loss of priority of a mortgage. Under common law and the Restatement, if an obligation secured by a mortgage is modified, the mortgage "retains priority as against junior interests in the real estate, except to the extent that the modification is materially prejudicial to the holders of such interests. . . ." Restatement Third) of Property—Mortgages § 7.3(b). However, parties must sometimes litigate whether a modification is materially prejudicial. The act creates certainty by providing that certain modifications of obligations do not cause a loss of priority. With greater clarity in the law, borrowers will avoid recording costs to maintain priority and costs of a title policy endorsement and of a legal opinion for many types of modifications.

4. **Recording.** For modifications within the safe harbor, recording a record of a mortgage modification is not required to maintain the priority of the mortgage, but recording may be desirable for other reasons. For example, if the mortgage itself is modified, a lender may want to record a modification agreement to give notice to third parties of the modifications. If the maturity date of a loan is extended, a lender may want to record a modification agreement to give public notice of the extension of the statute of limitations for enforcement of the mortgage.

5. **No novation.** A novation, in the context of a mortgage loan, means a replacement of the existing obligation with a new obligation. Courts may find that a modification of a loan is so substantial that it is treated as a new loan. If a modification is so substantial as to constitute a novation of the loan, some cases have held that the mortgage no longer secures the modified loan. *See, e.g.,* In re Fair Finance Co., 834 F.3d 651 (2016). Subsection (a)(4) provides that modifications that fall within the safe harbor are not so substantial as to constitute a novation. Thus, if a modification is within the safe harbor, the mortgage continues to secure the loan or other obligation.

6. **Safe harbor modifications.** Subsection (b) lists modifications that fall within the safe harbor. The listed modifications are those that generally would not be materially prejudicial to a junior interest holder. Some of the listed modifications, such as decreasing the interest rate or forgiving unpaid interest, would always be of benefit to a junior interest holder. Other modifications in the list would usually be beneficial to a junior interest holder.

a. **Extension of maturity date.** Most courts hold that a junior lienholder is not materially prejudiced by the extension of the maturity date of a loan. *See, e.g.,* Lennar Northeast Partners v. Buice, 57 Cal. Rptr. 2d 435 (Cal. Ct. App. 1996); Shultis v. Woodstock Land Dev. Assocs., 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993). The Restatement position is that an extension of the maturity of a senior mortgage loan is generally beneficial to junior lienholders because it makes foreclosure of the senior lien less likely. See Restatement Third) of Property—Mortgages § 7.3 cmt. c. An extension of the maturity of a loan is a very common modification, and clarity that it does not cause a loss of priority will save time and expense, facilitate loan modification to avoid foreclosure, and avoid litigation.

b. **Decrease in interest rate.** A decrease in the interest rate does not prejudice a junior interest holder. A decrease in the interest rate benefits a junior interest holder by decreasing the amount of the obligation and by making it more likely that the borrower can pay.

c. **Modification of method of calculating interest.** Parties may agree to change the index used for calculating interest or may change from a fixed to a variable rate or vice versa. Such a modification may result in an increase or decrease in the amount of interest owed, and the parties may not know at the time of the modification whether it will ultimately result in an increase or decrease in the total amount of interest to be paid. Subsection (b)(3) creates a safe harbor for those changes that do not result in an increase in the interest rate as calculated at the time of the modification. A temporary decrease in the interest rate with a later increase above the original rate would not be within the safe harbor if interest as calculated on the date of the modification would be more than before the modification. Whether a change from a fixed to a floating rate or vice versa is within the safe harbor is determined based on the floating rate on the date of the modification.

~~**QUESTION FOR THE COMMITTEE: Does Section 4(b)(3) as presently worded prevent gamesmanship by temporarily decreasing, then increasing, the interest rate? If not, should it be modified to apply only to a change from a floating or adjustable rate to a fixed rate?**~~

d. **Capitalization of unpaid interest or another unpaid obligation.** Capitalization of unpaid interest increases the principal of a loan; however, unpaid obligations are already owed and secured by a mortgage. Thus, it does not prejudice a junior lienholder in the same way that a new advance would. *See* Fraction v. Jacklily, LLC (*In re* Fraction), 622 B.R. 642 (Bankr. E.D. Pa. 2020), *aff'd,* 2021 WL 4037508 (E.D. Pa. 2021). Capitalization of unpaid interest is a modification that commonly occurs when a borrower is in default and the lender has agreed to the modification as an alternative to foreclosure. Avoiding foreclosure by a senior mortgage holder benefits a junior lienholder. In addition, when unpaid amounts are capitalized, the loan is no longer in default; thus, default interest and late charges will stop accruing, which also benefits a junior lienholder.

e. **Forgiveness or reduction of obligation.** Forgiving or otherwise reducing a monetary obligation benefits a junior interest holder.

f. **Insurance and escrow requirements.** Changes in the requirements for maintaining insurance and changes in requirements for maintaining an escrow account should not prejudice a junior lienholder and might be a benefit if the modification better protects the collateral and insures the payment of insurance premiums and taxes.

g. **Modification of an existing condition to an advance of funds.** If a loan already provides for an advance, the waiver or modification of a condition to that advance should not materially prejudice a junior lienholder in most circumstances. In a construction loan, the advance of funds allows the borrower to continue construction and to pay contractors and subcontractors, which should be of benefit to a junior lienholder.

h. **Modification of a financial covenant.** Financial covenants are commonly modified in commercial loans and should not generally cause material prejudice to a junior lienholder. Examples of financial covenants include requirements for a borrower to maintain a certain level of income or net worth, for maintenance of a certain loan-to-value ratio or debt service ratio, for furnishing financial records, for production of tax returns, and for maintenance of deposit accounts with the lender.

i. **Modification of payment amount or schedule.** Some of the safe harbor modifications may result in changes in the payment amount or schedule. For example, a decrease in the interest rate may result in lower payments, and an extension of the maturity date of a loan will result in a changed payment schedule. These modifications are also within the safe harbor.

7. **Modifications not within the safe harbor.** Modifications that are not within the safe harbor are governed by other law. Under common law, a mortgage as modified retains its priority except to the extent that a modification materially prejudices junior interest holders. *See* Fraction v. Jacklily, LLC (*In re* Fraction), 622 B.R. 642, 649 (Bankr. E.D. Pa. 2020), *aff'd,* 2021 WL 4037508 (E.D. Pa. 2021). Under the Restatement, a "mortgage as modified retains priority as against junior interests in the real estate, except to the extent that the modification is materially prejudicial to the holders of such interests . . . ." Restatement (Third) of Property—Mortgages § 7.3(b). The safe harbor modifications in this act are those that generally would not prejudice a junior interest holder. Other modifications may or may not materially prejudice a junior interest holder and thus may or may not cause a loss of priority. Note that a modification may result in a split priority with the senior mortgage losing priority only to the extent the that the modification prejudices the junior interest holder. *See, e.g.,* Shultis v. Woodstock Land Dev. Assocs., 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993).

8. **Examples.** The following examples illustrate the operation of this section.

a. **Example 1:** A lender makes a loan evidenced by a promissory note in the principal amount of $100,000 secured by a mortgage. The interest rate on the loan is 7% per annum. A creditor obtains a judgment lien against the mortgaged property. The borrower and lender subsequently agree to extend the term of the loan for an additional five years, to reduce the interest rate to 6% per annum, and to require flood insurance. The modifications result in a change in the borrower's payments. Because the modifications are all within the safe harbor list, the lender retains its priority as against the judgment lien creditor. Recordation of a modification agreement is not necessary to retain priority, but the lender may choose to require recordation in order to extend the statute of limitations based on the new maturity date.

b. **Example 2:** A lender makes a loan evidenced by a promissory note in the principal amount of $100,000 secured by a mortgage. The loan does not provide for additional advances. A creditor obtains a judgment lien against the mortgaged property. The borrower and lender subsequently agree to modify the loan to increase the principal amount of the loan to $150,000, and the lender advances the additional $50,000. Because this modification is not within the safe harbor list and materially prejudices a junior interest holder, the lender will lose priority to the extent that the judgment lien creditor is prejudiced. Most courts would hold that the priority is split, with the lender retaining priority as to the original loan terms and losing priority only as to the new advance. *See, e.g.,* Shultis v. Woodstock Land Dev. Assocs., 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993) (split priority for increase in interest rate).

c. **Example 3:** A lender makes a loan evidenced by a promissory note in the principal amount of $100,000 secured by a mortgage on the borrower's home. The borrower subsequently obtains a home equity loan in the amount of $20,000. The borrower later goes into default on the first mortgage loan and negotiates with the loan servicer to modify the loan. Modifications include an extension of the maturity date of the loan by three years, a reduction in the interest rate on the loan for two years, the capitalization of unpaid interest, and the addition of an escrow requirement for taxes and insurance. The first lien lender retains its priority as against the home equity loan because the modifications are all within the safe harbor. Recordation of a modification agreement is not necessary to retain priority.

d. **Example 4:** A lender makes a construction loan in the principal amount of $100,000 secured by a mortgage. The loan agreement lists conditions which must be satisfied before each advance of funds. The lender agrees to waive one of the conditions to an advance so that construction may continue. The lender retains its priority as against any mechanic's liens because the waiver of the condition is within the safe harbor list. Recordation of a modification agreement is not necessary to retain priority.

e. **Example 5:** A lender makes a construction loan in the principal amount of $100,000 secured by a mortgage with a floating interest rate based on an index. Because of a dispute with a subcontractor, the subcontractor has filed a mechanic's lien, which is subordinate to the lender's construction loan. After construction is complete, the parties negotiate to extend the maturity of the loan by five years, to fix the interest rate at a rate that is 1% lower than the floating rate on the date of the closing of the modification, and to add financial covenants. The promissory note is restated with only the listed modifications. The lender retains its priority as against the mechanic's liens because the modifications are all within the safe harbor list. Recordation of a modification agreement is not necessary to retain priority.

f. **Example 6:** A lender makes a loan evidenced by a promissory note in the principal amount of $100,000 secured by a mortgage. The interest rate on the loan is fixed at 7%

per annum. A creditor obtains a judgment lien against the mortgaged property. The borrower and lender subsequently agree to change the interest rate to 1% above SOFR. On the date that the modification becomes effective, the interest rate calculated as 1% above SOFR is less than 7%. Because the modification of the interest rate is within the safe harbor list, the lender retains its priority as against the judgment lien creditor.

g. **Example 7:** A lender makes a loan evidenced by a promissory note in the principal amount of $100,000 secured by a mortgage. A creditor subsequently obtains a judgment lien against the mortgaged property. The borrower is in financial distress, and the borrower and lender negotiate numerous modifications to the loan. Some of the modifications are within the safe harbor list and others are not. If a court determines that the modifications not within the safe harbor are not materially prejudicial to the judgment lien creditor, the lender retains its priority under common law.

Section 5. Uniformity of Application and Construction

In applying and construing this uniform act, a court shall consider the promotion of uniformity of the law among jurisdictions that enact it.

Section 6. Relation to Electronic Signatures in Global and National Commerce Act

This [act] modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq.[, as amended], but does not modify, limit, or supersede 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in 15 U.S.C. Section 7003(b).

Legislative Note: *It is the intent of this act to incorporate future amendments to the cited federal law. A state in which the constitution or other law does not permit incorporation of future amendments when a federal statute is incorporated into state law should omit the phrase ", as amended". A state in which, in the absence of a legislative declaration, future amendments are incorporated into state law also should omit the phrase.*

Reporter's Note

The federal Electronic Signatures in Global and National Commerce Act, popularly known as "E-Sign", was adopted in 2000 to facilitate the use of electronic records and signatures in commercial transactions. Subject to exceptions not relevant here, E-Sign mandates the acceptance of electronic contracts and electronic signatures in interstate or foreign commerce. It largely tracks the Uniform Electronic Transactions Act, adopted by the ULC in 1999, but includes consumer consent provisions and prohibits state law from giving greater legal effect to any specific technology or technical specification. Under Section 102 of E-Sign, state legislation attempting to regulate electronic records and signatures can opt out of federal preemption, allowing some modification to the federal law, so long as the State treats the records or signatures consistent with E-Sign. In order to take advantage of the exception to preemption, the state law must take specific reference to E-Sign as provided in Section 6. See 15 U.S.C. Section 7002(a)(2)(B).

Section 7. Transitional Provision

This [act] applies to a mortgage modification made on or after [the effective date of this [act]] regardless of when the mortgage or the obligation was created.

Reporter's Notes

1. **Prospective application.** The act applies prospectively to mortgage modifications that occur on or after the effective date of the act. It does not apply retroactively to modifications that occurred before the effective date of the act. The act can apply to a modification made to the terms of a mortgage or to a record that creates, evidences, or secures an obligation that was created before the effective date of the act as long as the modification occurs after the effective date of the act.

2. **Example:** At the time that the act becomes effective, A has a first mortgage, and B has a second mortgage on a borrower's property. After the effective date of the act, A and the borrower modify the first mortgage loan to extend its maturity. The act applies, and A does not lose priority.

[Section 8. Severability

If a provision of this [act] or its application to a person or circumstance is held invalid, the invalidity does not affect another provision or application that can be given effect without the invalid provision.]

Legislative Note: *Include this section only if the state lacks a general severability statute or a decision by the highest court of the state stating a general rule of severability.*

~~[~~**Section 9.** ~~**Repeals; Conforming Amendments**~~

~~(a) . . .~~

~~(b) . . .]~~

~~***Legislative Note:*** *A state should examine its statutes to determine whether conforming revisions are required by provisions of this act relating to mortgage modifications.*~~

~~**QUESTION FOR THE COMMITTEE: Style Committee said we need to include a**~~

~~**description of the statutory subject matter to be examined for consistency or to delete Section 9 altogether. Which do we prefer?**~~

~~Section 10.~~ Effective Date

This [act] takes effect . . .

~~**ISSUE FOR THE COMMITTEE: WAIVER. The committee discussed waiver during our Zoom meeting in December but did not reach any consensus.**~~

~~**The reporter's thoughts on this issue:**~~

1. ~~**First lienholders would be very unwise to put a waiver of the act in loan documents because the act benefits them.**~~
1. ~~**If a second lienholder requires waiver by the borrower, the waiver by the borrower alone would not be effective because the act benefits the first lienholder.**~~
2. ~~**Second lienholders can prohibit modification of the first lien without the consent of the second lienholder. That is not a waiver of the act, but a breach by the borrower would be a default that would allow the second lienholder to accelerate and foreclose.**~~
3. ~~**In commercial deals where the first lienholder can prohibit second lien financing, first and second lienholders typically enter into an intercreditor agreement. Is a provision necessary if agreements are permitted?**~~

~~**The Chair's thoughts on this issue:**~~

1 ~~**Couldn't a lender bury a waiver in a 50-page loan agreement? ("Loan agreement" means an agreement between a lender and a borrower, not an intercreditor agreement between lenders.) If the mortgage incorporates the loan agreement by reference, third parties would be on notice of its provisions, at least in my state.**~~

2 ~~**Wouldn't allowing a waiver produce chaos in the land records? Would people searching the land records know whether a mortgage or a mortgage modification has priority or not?**~~

3 ~~**We are not talking about only waiving rights between parties, we are also talking about waiving the effects of this act on the public land records that third parties rely upon.**~~

4 ~~**The UCC does not allow parties to waive the effect of the UCC on the public records. But the UCC allows parties to enter into intercreditor agreements, subordination agreements and other agreements without waiving the UCC. So, even if we were not to permit a waiver of this act, lenders would be able to enter into intercreditor agreements, subordination agreements, and other agreements governing the priority of liens and security interests on real property and personal property without waiving the UCC, this act, or any other act that I can think of.**~~

~~5 The act contains only one, simple substantive section, and one simple scope section. It's not rocket science. Would we want to allow the parties to vary Section 3(c) and make this act applicable to transfers of the loan, or to changes in the collateral or the obligor. Or to vary Section 4(b) and add more modifications to the safe harbor? If not, why should we strain to allow them to do so?~~

~~6 If we were to allow waiver, what would be the reaction of the title industry, mechanic lien holders, and county recorders? Would they support the act in the legislatures or oppose it?~~

~~7 If we were to allow waiver, would we impair enactability? Would very many states enact our act?~~

~~8 If the committee wishes to address waiver, I suggest a simple anti-waiver provision. The anti-waiver provision could be supplemented by another provision in the text or in a reporter's note stating that the anti-waiver provision does not interfere with the long-standing practices of such things as subordination agreements and intercreditor agreements in which lenders agree among themselves about their respective liens, including priority.~~

~~9 I am concerned that going beyond this simple approach weould risk crippling the act by adding a provision at the last meeting that is far-reaching and that we may have not had enough time to thoroughly think through and draft. If we were to attempt to do so, would we would risk overlooking material matters and drafting too broadly, too narrowly, or otherwise erroneously.~~

~~**A provision for consideration:**~~

~~**Section __. Variation by Agreement.**~~

~~**(a) {Except as provided in subsection (b),} the effect of this [act] may not be varied by agreement, and rights conferred by it may not be waived.**~~

~~**{(b) An agreement between the holders of mortgages encumbering the same property {and signed by all obligors} may prohibit mortgage modifications without consent of the other mortgage holder or may dictate the effect of a mortgage modification on priority of the mortgages.**~~