

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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Table of Contents

Section 1. Title	8
Section 2. Definitions.....	8
Section 3. Non-Residential Loan Modification	10
Section 4. Residential Loan Modification	11
[Section _. Uniformity of Application and Construction]	12
[Section _. Relation to Electronic Signatures in Global and National Commerce Act] {Insert if necessary.}	12
[Section _. {Saving Provision}].....	13
Section _. Transitional Provision.....	13
[Section _. Severability].....	13
[Section _. Repeals; Conforming Amendments]	13
Section _. Effective Date	13

Mortgage Modifications Act

Reporter's Prefatory Note

The parties to a mortgage loan often agree to modify the terms of the secured indebtedness or obligations. Typical modifications include extending the maturity date of the loan, increasing or decreasing the interest rate or changing the method by which interest is calculated, and increasing the principal of the loan by agreeing to new advances or by capitalizing unpaid interest. The parties often agree to modifications in response to a mortgagor's default in payment or the mortgagor'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. In addition, a lender will sometimes consent to the sale of mortgaged property, leaving existing financing in place, upon an increase in the interest rate of the loan.

When the terms of a mortgage loan are modified, the common law is not clear as to whether the parties must execute and record a modification of the mortgage instrument. Nor is the common law clear as to whether a modification affects the priority of the mortgage with respect to junior lienholders. The recordation issue affects parties who acquire interests in the mortgaged property after a modification. The question is what types of modifications should be placed of record to give notice to parties who acquire an interest after the modification. The priority issue, on the other hand, affects parties who acquired their interests in the mortgaged property after recordation of the mortgage but before the modification. The question is what types of modifications are prejudicial to their preexisting junior interests. A third issue is whether a loan modification is a novation, which could cause the loan to be unsecured.

Recordation of a modification agreement

Relevant to the first issue—whether a recorded modification agreement is required—is that most jurisdictions do not have requirements as to which loan terms that must be included in a mortgage. Restatement (Third) of Property: Mortgages § 1.5, reporter's note (1997). Some states do have statutory requirements that a mortgage state the maximum principal that the mortgage can secure. To the extent that a loan term must be included in a mortgage, recordation of a modification of that term is likely required in those states.

The maturity date of a loan, while not generally required to be included in a mortgage, is usually stated in a mortgage because the omission of the maturity date in the mortgage may have consequences as to the application of the statute of limitations. Thus, failure to record a modification of the maturity date could have similar consequences as to the application of the statute of limitations. Furthermore, certain changes to the mortgage itself, such as adding or releasing collateral would require recordation of a document to perfect the lien and set the priority of the mortgage as to new collateral or to clear title in case of a partial release.

Because cases provide little guidance as to the first issue, borrowers are required to suffer the delays and incur the expense of the preparation and recordation of an amendment to the mortgage even when the modification is of loan terms that are not created by or disclosed in the mortgage. The act is intended to provide clarity by creating a safe harbor for certain types of

1 modifications to the terms of a loan that do not require recordation of a modification agreement.
2 Modifications that are not within the safe harbor will continue to be governed by other law.

3 4 **Priority**

5
6 With regard to the second issue—whether a loan modification affects the priority of a
7 mortgage—a large number of reported cases exist, but they do not provide sufficient guidance in
8 resolving the issue. The Restatement view, which is the prevailing view and often cited by
9 courts, is:

10
11 If a senior mortgage or the obligation it secures is modified by the parties, the
12 mortgage as modified retains priority against junior interest in the real estate,
13 except to the extent that the modification is materially prejudicial to the holders of
14 such interests

15
16 Restatement (Third) of Property: Mortgages § 7.3(b) (1997). What is not clear from the case law
17 is which modifications are materially prejudicial to junior interests and which are not.

18
19 The priority cases consider various types of modifications such as extensions of the
20 maturity of a loan, increases in the principal of a loan, and changes in the interest rate, and
21 determine based on the particular facts of the case whether the modification materially prejudices
22 a junior interest holder. A number of cases find that an increase in the principal of a loan causes a
23 loss of priority, usually only to the extent of the increase. Restatement § 7.3 cmt. c. Most of the
24 cases addressing an extension of the maturity of a loan find that a junior lienholder is not
25 materially prejudiced and is in fact benefitted because the senior lender is extending the loan
26 rather than foreclosing and cutting off the junior lien. *Id.* Some cases, however, hold otherwise,
27 finding that an extension is materially prejudicial. Thus, the cases do not provide sufficient
28 guidance and require litigation to resolve the issue.

29
30 This act is intended to provide clarity by creating a safe harbor for modifications that do
31 not affect the priority of a mortgage. Those modifications that do not fit within the safe harbor
32 will continue to be governed by other applicable law. Many loan modifications only affect the
33 obligations that are secured by a mortgage rather than modifying the terms of the mortgage itself.
34 Some types of modifications, such as increasing the principal of a loan, clearly prejudice junior
35 lienholders. Other types of modifications, such as decreasing the interest rate on a loan, clearly
36 do not prejudice junior lienholders. The intent of the act is to exclude from the safe harbors of
37 the act those types of modifications to the secured obligations that materially prejudice junior
38 lienholders, leaving other modifications of the secured obligations within the safe harbors.

39 40 **Novation**

41
42 The act will make clear that if a mortgage provides that it secures an obligation as
43 modified, the mortgage will secure the obligation as modified even if the modification might
44 otherwise be treated as a novation. [Should there be exceptions or should the act make the
45 language of the mortgage effective regardless of the type of modification?]

Purpose

The act will save time and money for parties who wish to modify the terms of their loans in ways that fit within the safe harbors by avoiding the need to obtain title updates to determine whether there is a junior lien and by avoiding the need to prepare and record a mortgage amendment. If mortgaged property is encumbered with a junior lien, the parties can avoid the necessity of obtaining consent from the lienholder and may avoid later litigation over priority if no consent is given.

When a mortgagor is in default in payment or otherwise in financial distress, a modification can be an alternative to foreclosure that benefits both parties. The lender hopes that a modification will result in a performing loan, and the borrower hopes to retain ownership of the mortgaged property. In the case of a residential mortgage loan, the borrower hopes to avoid foreclosure and loss of the home.

The act is intended to remove some roadblocks to modification by making the law more certain and by protecting the priority of a mortgage for certain common modifications that would not typically cause a material prejudice to a junior interest holder. 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.

[Residential and non-residential loan modifications]

The act distinguishes residential and commercial mortgage loans because of some important differences between them. Commercial mortgages typically contain a “due-on-encumbrance” clause, which allows a lender to accelerate the loan if the borrower allows a second mortgage or other subordinate lien on the property without the consent of the superior lienholder. Thus, second liens are rare, and when the senior lender does consent, the lenders may enter into an inter-creditor agreement that governs the issue of priority in case of a modification. When senior lenders do agree to additional financing, it is often mezzanine financing secured by ownership interests in the borrowing entity rather than by the real property, and an inter-creditor agreement is typical. As a result, junior consensual lienholders are not often affected by the modification of a senior mortgage loan. However, commercial properties may be encumbered by judgment liens or mechanic’s liens.

With respect to residential mortgage loans, a lender may not accelerate based on “the creation of a lien or other encumbrance subordinate to the lender’s security instrument which does not relate to a transfer of rights of occupancy in the property.” 12 U.S.C. §1701j-3(d)(1). Thus, residential borrowers can and often do have subordinate financing in the form of a home improvement loan, a home equity loan, or a home equity line of credit.

Commercial loans are also much more diverse in their terms as compared to residential mortgage loans, most of which use standardized Fannie Mae/Freddie Mac form documents. Thus, the types of modifications that the parties may wish to make also vary more for commercial loans. Reasons for modification are also more diverse for commercial loans. Residential mortgage loans are rarely modified except to address a default by the borrower or the

1 borrower's financial distress. For residential loans, competing policies exist favoring the
2 availability of secondary financing and modification of distressed loans in order to prevent
3 foreclosure of a home.]

4
5 {The Prefatory Note will continue with a description of the act.}

Mortgage Modifications Act

Section 1. Title

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

Section 2. Definitions

In this [act]:

(1) “Loan document” means a promissory note, credit agreement, loan agreement, or other agreement creating indebtedness or other obligations secured by a mortgage. The term does not include a mortgage.

(2) “Modify” means change, amend, or revise. The term includes supplement and restate. The term “modification” has a correlative meaning.

(3) “Mortgage” means a security instrument that creates a consensual interest in real property to secure payment or performance of an obligation. The term includes a deed of trust [but does not include a security instrument that creates a consensual interest to secure an obligation owed to a homeowners’ association in a common-interest community].

(4) “Non-residential mortgage loan” means a loan secured by a mortgage that is not a residential mortgage loan.

(5) “Obligation” means a debt or other duty or liability secured by a mortgage.

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

(7) “Record”, used as a verb, means to submit a document complying with applicable legal standards, with required fees and taxes paid, to the appropriate governmental office under [the recording act of this State].

(8) “Residential mortgage loan” means a loan secured by a mortgage on residential real property.

(9) “Residential real property” means real property that, when a mortgage is entered into with respect to the property, is used or is intended by its owner to be used primarily for the personal, family, or household purposes of its owner and is improved, or intended by its owner to be improved, by one to four dwelling units. The term includes:

(i) an attached single-family unit;

(ii) a single-family manufactured-housing unit or a time share in a dwelling unit if either is treated as real property under law of this state other than this [act]; and

(iii) a single-family unit in a common-interest community.

(10) “State” means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any other territory or possession subject to the jurisdiction of the United States. The term includes a federally recognized Indian tribe.

Reporter’s Notes

1. The term “loan agreement” is intended to encompass any type of agreement that creates an obligation secured by a mortgage. It is intended to include a promissory note, a credit agreement, a loan agreement, a construction loan agreement, a consumer credit agreement, or any other type of agreement secured by a mortgage. However, it does not include the mortgage itself.

2. The term “modify” is intended to be very broad and thus to encompass any type of modification or change that parties might make to a loan document, including a supplement to or a restatement of a loan document. “Modification”, as the corresponding noun, has a corresponding meaning.

3. The term “mortgage” is intended to include not only mortgages but also deeds of trust and other consensual real property security interests. It is based upon the definition in the Model Negotiated Alternative to Home Foreclosure Act; however, in this act, the term refers to the instrument rather than to the interest in property. The Model Act excludes homeowners’ association liens, and we need to consider whether our act should also exclude them. If we do exclude homeowners’ association liens, do we need to define common-interest community, as does the Model Act, or is the term sufficiently self-explanatory in the context of this act?

1 4. A “non-residential mortgage loan” is a commercial mortgage loan or any other
2 mortgage loan that is not a residential mortgage loan as that term is defined.
3

4 5. The definition of the term “obligation” comes from the Model Negotiated Alternative
5 to Foreclosure Act. As in the Model Act, the term includes a non-recourse debt. Should that be
6 stated in the definition itself? Also, to consider is whether we need a separate definition for debt
7 to be used when the act refers to monetary obligations as in section 3(b)(1-3) and 4(b)(1-3).
8

9 6. The definition of “person” comes from the ULC Drafting Rules and Style Manual.
10

11 7. The definition of “record” used as a verb comes from the Uniform Nonjudicial
12 Foreclosure Act and the Uniform Assignment of Rents Act.
13

14 8. A “residential mortgage loan” is one that is secured by residential real property as that
15 term is defined in the act. By using that defined term, the definition includes the requirement that
16 the loan be for personal, family, or household purposes.
17

18 9. The definition of “residential real property” comes from definition of that term in the
19 Uniform Nonjudicial Foreclosure Act and includes examples from the definition of mortgaged
20 property in the Model Negotiated Alternative to Foreclosure Act. In the Model Act, the character
21 of property as residential is determined at the time of foreclosure, which is not applicable in this
22 act. This definition (and the one in the Uniform Act) determines the residential character of the
23 property at the time the loan is made.
24

25 10. The definition of “state” comes from the ULC Drafting Rules and Style Manual.
26

27 **Section 3. Non-Residential Loan Modification**

28 (a) Except as provided in subsection (b), if a recorded mortgage securing a non-
29 residential mortgage loan provides that the mortgage secures obligations under a loan document
30 as it may be amended, modified, supplemented, or restated, or words of similar effect, the
31 mortgage secures the obligations under the loan document as modified without the necessity of
32 recording an amendment to the mortgage and without regard to whether the modification may
33 otherwise constitute a novation of the obligations under the loan document and has the same
34 priority as the priority of the original recorded mortgage.

35 (b) Subsection (a) does not apply to a modification that:

36 (1) increases the amount of the principal of the obligation [except if the increase is

a capitalization of unpaid interest or other unpaid obligations],
[(2) extends the maturity date of the obligation if the maturity date is stated in the
original mortgage,]
[(3) increases the interest rate of the obligation if the interest rate is stated in the
original mortgage,] or
[(4) occurs at the time of a transfer of [the ownership or right to enforce] a loan
document.]
(c) A modification described in subsection (b) is governed by the law that would apply
without regard to this [act].

Reporter's Notes

1. Section 3 applies to non-residential loans.

2. Subject to exceptions in subsection (b), subsection (a) is intended to create a safe harbor for modifications of a loan document if a mortgage provides that it secures loan documents as modified. Most mortgages do in fact have a provision to this effect. If modifications are within the safe harbor, no need exists for the recordation of a modification agreement, and the mortgage retains its original priority.

3. Subsection (b) lists exceptions to the safe harbor—those types of modifications that the act does not alleviate the necessity for recording or protect the priority of the mortgage, in which case those issues are determined by other law as provided in subsection (c). If the committee determines that the exceptions as related to the recordation issue and the priority issue are different, section 3 may need to be divided into two sections—one for each issue—or the exceptions may need to be listed in separate subsections for the two issues.

4. The exceptions and possible exceptions to the safe harbor are discussed in an issues memo.

Section 4. Residential Loan Modification

(a) Except as provided in subsection (b), if a recorded mortgage securing a residential mortgage loan provides that the mortgage secures obligations under a loan document as it may be amended, modified, supplemented, or restated, or words of similar effect, the mortgage

1 secures the obligations under the loan document as modified without the necessity of recording
2 an amendment to the mortgage and without regard to whether the modification may otherwise
3 constitute a novation of the obligations under the loan document and has the same priority as the
4 priority of the original recorded mortgage.

5 (b) Subsection (a) does not apply to a modification that:

6 (1) increases the amount of the principal of the obligation [except if the increase is
7 a capitalization of unpaid interest or other unpaid obligations],

8 [(2) extends the maturity date of the obligation if the maturity date is stated in the
9 original mortgage,]

10 [(3) increases the interest rate of the obligation if the interest rate is stated in the
11 original mortgage,] or

12 [(4) occurs at the time of a transfer of [the ownership or right to enforce] a loan
13 document.]

14 (c) A modification described in subsection (b) is governed by the law that would apply
15 without regard to this [act].

16 **[Section __. Uniformity of Application and Construction]**

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

19 **[Section __. Relation to Electronic Signatures in Global and National Commerce Act]**

20 **{Insert if necessary.}**

21 This [act] modifies, limits, or supersedes the Electronic Signatures in Global and National
22 Commerce Act, 15 U.S.C. Section 7001 et seq.[, as amended], but does not modify, limit, or
23 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.]*

[Section __. {Saving Provision

If a saving provision is necessary, include appropriate language. See Rule 403.}]

Section __. Transitional Provision

(a) This [act] applies to a mortgage modification made on or after [the effective date of this [act]].

(b) This [act] applies to a mortgage created on, after, or before [the effective date of this [act]].

[Section __. 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 __. 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 { }. See Section { }.*

Section __. Effective Date

This [act] takes effect . . .