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Complying with lender closing instructions: What happens when they're wrong? - by Jonathan Anderson

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CATIC, along with every other title company, issues Closing Protection Letters for its agents when requested by a lender. Lenders request one for nearly every closing. In issuing the letter, CATIC agrees to protect the lender against any actual loss or damage the lender suffers as a result of the CATIC closing attorney's failure to follow the lender's closing instructions. The fact that title companies are willing to offer such coverage encourages lenders to use agents to close loans, but what happens when the closing instructions are in error, and following them would result in a title problem?

One of the most common situations in which this happens is where the property is owned by two people, usually a husband and wife, and only one is a borrower. The lender's instructions will indicate that only the borrower needs to sign the mortgage, and the mortgage deed will come through with only the borrower's name as the grantor. If the agent follows the lender's instructions without doing more, the lender will have a mortgage on a partial interest in the property. That is almost never the lender's intent, but an agent cannot ignore the lender's instructions or mark up the mortgage deed without the lender's approval.

The first step is to contact the lender to point out that title is held in part by someone who is not a borrower and is not directed by the existing instructions to sign the mortgage deed. The lender must be told that the mortgage will encumber only the partial interest that the borrower/owner has in the property. If it is even possible for one of the owners to mortgage a partial interest in the property, the lender must also confirm in writing that the mortgage is intended to encumber only that partial interest, and the description of the Land in the title policy must reflect that partial interest as well. The policy's Schedule B will also take an exception for the rights of the other co-owner.

If the lender expects to take a mortgage on the entire interest in the property, then each owner of the property needs to sign the mortgage. The issue arising in that case is whether the lender will agree to have any non-borrower, who also owns an interest in the property, sign the mortgage deed. The mortgage should identify in the granting clause the party or parties who are signing the mortgage deed but are not borrowers on the note, with a recital that the consideration for these additional grantors to give the mortgage is the extension of credit to the borrower. The mortgage should contain an acknowledgment block for the borrower as well as any additional non-borrower /grantor.

If the lender will not allow a non-borrower who will remain a partial owner of the property to sign the mortgage, then the lender's title insurance policy will be issued with the limitation set forth above, provided the law in the state where the mortgage is being recorded allows a valid mortgage to be created on a partial interest when that mortgage is granted by only one of the co-owners. It is

important to note that in some states, where the property is held by husband and wife as tenants by the entirety, the title insurance policy will not be able to insure the validity and enforceability of the mortgage unless both husband and wife execute the mortgage deed.

If the lender insists that only the borrower sign the mortgage deed but also requires that the entire interest in the property be encumbered by the mortgage, then any non-borrower/owner must transfer their entire interest to the borrower prior to the granting of the mortgage. Be aware that the transfer could have federal and state tax implications for the transferor as well as implications for their estate plan, and should not be undertaken lightly. In some states, there could also be homestead rights in favor of the non-owner spouse.

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