A Homeowner's Mortgage Insurance Obligation is Not Modified by a Mortgage Modification

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Mortgage insurance can be an expensive proposition for homeowners at the same time that it provides assurance to lenders. Whether the term of paying insurance premiums can be extended as the result of a mortgage modification was the topic of the recent decision by the Court of Appeals for the Third Circuit in ***Ginnine Fried v. JP Morgan Chase & Co; JP Morgan Chase Bank NA, d/b/a Chase*****,** — F.3d —- (3d Cir. 2017), 2017 WL 929752 (3d. Cir. Mar. 9, 2017). The case involved a homeowner who sued JP Morgan Chase Bank ("Chase") for unlawfully extending the requirement to purchase homeowner's insurance. In reaching its decision, the Court of Appeals examined the provisions of the Homeowners Protection Act ("Protection Act"), 12 U.S.C. § 4901 *et seq.,* and concluded that the homeowner was correct. Writing for the appellate court, Judge Ambro asked: "Does it [the Protection Act] permit a servicer to rely on an updated property value, estimated by a broker, to recalculate the length of a homeowner's mortgage insurance obligation following a modification or must the ending of that obligation remain tied to the initial purchase price of the home? We conclude the Protection Act requires the latter."*Ginnine Fried v. JP Morgan Chase & Co; JP Morgan Chase Bank NA, d/b/a/ Chase,* No. 16-3069, 2017 WL 929752, at *1 (3d Cir. Mar. 9, 2017).

The facts were that the plaintiff homeowner, Ginnine Fried, bought a home in 2007 for $553,330. The appraisal obtained at the time estimated the home's value to be $570,000. To have the funds to purchase the home, Fried borrowed $497,950 at a fixed interest rate and granted a mortgage on her home as security. Because the loan-to-purchase-price was more than 80%, Chase (the servicer for the loan) required private mortgage insurance, adding the monthly premiums to her payments, until the ratio reached 78%. Fried would pay those premiums until the principal of the loan reached $431,597, which was projected to happen just before March 2016.

Within a short time, Fried had difficulty making mortgage payments and sought assistance through Home Affordable Mortgage Program ("HAMP"), a federal aid program. Chase obtained a Broker's Price Opinion ("BPO") to support the modified loan. Chase contended that it could recalculate the 80% loan-to-purchase-price ratio to conform to the new principal balance. That is, Chase substituted its BPO of $420,000 for the home's $553,330 original value. Because the BPO was much smaller, Fried would not pay down her outstanding principal balance to 78% of the BPO (78% x $420,000 = $327,600) until November 1, 2026. Thus, although the principal balance was reduced to $463,737, Chase extended Fried's mortgage insurance premiums an extra decade to 2026. If Chase had used the initial 78% value of $431,597 rather than the $327,600 balance, under the modified mortgage, the outstanding principal balance would reach 78% of her home's original value ($431,597) in July 2014.

The Court began its discussion with the requirement of the Protection Act, 12 U.S.C. § 4902(d):

> If a mortgagor and mortgagee (or holder of the mortgage) agree to a modification of the terms or conditions of a loan pursuant to a residential mortgage transaction, the cancellation date, termination date, or final termination shall be recalculated to reflect the modified terms and conditions of such loan.

The Protection Act clearly required Chase to change the termination date of the modified mortgage in the process of recalculating the principal balance and payment terms. However, the Court did not view the Protection Act as authorizing a change to the initial loan-to-purchase-price ratio inasmuch as "the Protection Act updates the termination date only with respect to the loan provisions that the parties 'agree' to modify." *Ginnine Fried, supra*, 2017 WL 929752, at *6. Fried did not agree to an extension of the time during which she would have to pay mortgage insurance. The 10-year extension made a significant difference in the payments Fried would be required to make. As the Court explained:

> In this way, the Protection Act's mortgage insurance termination date sets a finish line that homeowners go toward by paying down their mortgage debts. Fried started with a mortgage debt of $497,950 and would reach her finish line once the outstanding principal debt was $431,597. Put differently, she would cross this threshold after making $66,353 of payments toward her mortgage's principal balance, which, according to her initial amortization schedule, she would do in 2016. When her mortgage was modified, Fried leapt forward toward her goal: the modification decreased her outstanding principal balance to $463,737, so she would reach the $431,597 finish line sooner, in 2014, by making just $32,140 in principal payments. But when Chase substituted the BPO for the original value of Fried's home, it moved the finish line. Seventy-eight percent of the $420,000 BPO is $327,600. According to her modified amortization schedule, Fried would not pay down her mortgage debt to Chase's new $327,600 finish line—more than $136,137 in mortgage principal payments away—until 2026 Idat *3.

Chase also argued that HAMP required, or at least authorized, the change because the revised calculation pursuant to the BPO it obtained was a "condition" of the modification. While acknowledging that a BPO is one form of property value assessment that a bank can use when considering a loan modification, the Court did not view the new calculation as replacing the original value of Fried's property for mortgage insurance purposes. Rather, Judge Ambro returned to the language of the Protection Act as relying on "changes to the terms and conditions of the loan itself. No matter what led to the modification, the key inquiry is which of the *loan's* terms and conditions were modified, not any conditions precedent." *Id.* at *5. The Court noted that nothing in HAMP's requirements required substitution of the BPO for the original value, which the parties agreed was the original purchase price of the property.

Looking for support for its argument, Chase cited the Protection Act's statutory structure and legislative history. The Court disagreed that either supported Chase. Rather, the Court noted:

> Congress amended in 2000 the Protection Act with respect to loan modifications and refinancing transactions. *See* Private Mortgage Insurance Technical Corrections and Clarification Act (the "Corrections Act"), P.L. 106-569, 114 Stat. 2944 (2000) (amending 12 U.S.C. §§ 4901, 4902, 4903, 4905). The purpose of the Corrections Act was, among other things, to eliminate "uncertainty relating to the cancellation and termination of [mortgage insurance] for … loans whose terms or rates are modified over the life of the loan." 146 Cong. Rec. H. 3578-02, H3579 (May 23, 2000).
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> With respect to mortgage refinance transactions, which are distinct from mortgage modifications, Congress amended the definition of "original value" such that "[i]n the case of a residential mortgage transaction for refinancing the principal residence of the mortgagor, [original value] means only the appraised value relied upon by the mortgagee to approve the refinance transaction." 12 U.S.C. § 4901(12). Thus, when a homeowner refinances her home mortgage loan, the "original value" of her home will become the appraised value relied on by the mortgagee.6 And, accordingly, her termination date will reflect the new "original value." *See* 12 U.S.C. § 4901(18).
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> But for mortgage modifications Congress did not make any such provision to update a home's original value. . . .

Id. at *7.

The Court explained that a modification is an alteration or amendment to the existing mortgage contract, not a new "residential mortgage transaction." *See* 12 U.S.C. § 4901(15). "Congress reasonably chose to treat mortgage modifications and refinancing transactions differently. Its explicit command to update the original value of a home when a mortgage is refinanced is strong evidence that it declined to permit such an update impliedly for mortgage modifications." *Id.* at *8.

Chase next relied on the premise that the Court should defer to Fannie Mae's interpretation of the Protection Act under the doctrine of *Skidmore v. Swift & Co*., 323 U.S. 134 (1944). Once again, the Court disagreed, noting, *inter alia,* that Fannie Mae's Guidelines "simply do not square with the text of the Protection Act" and that neither Fannie Mae nor Freddie Mac administer the Protection Act, and neither is an administrative agency. Rather, both "are federally-chartered but privately owned corporations that issue publicly traded securities." *Id.* at *9 (quoting *Delaware Cty., Pa. v. Fed. Hous. Fin. Age*ncy, 747 F.3d 215, 219 (3d Cir. 2014) (footnote omitted).

After discussing a statute of limitations issue concerning the specific facts of the case, the Court concluded that "[w]hen it passed the Protection Act, Congress made a tradeoff between precision and predictability that we are not free to rebalance." The Court affirmed the District Court's refusal to dismiss the action, holding that Fried had stated a claim that Chase violated the Protection Act, and remanded for further proceedings.

A lesson for lenders: the initial purchase price of the residence will govern the loan-to-purchase-price ratio for purposes of homeowner's mortgage insurance.

For additional information contact Hon. Judith K. Fitzgerald (Ret.)