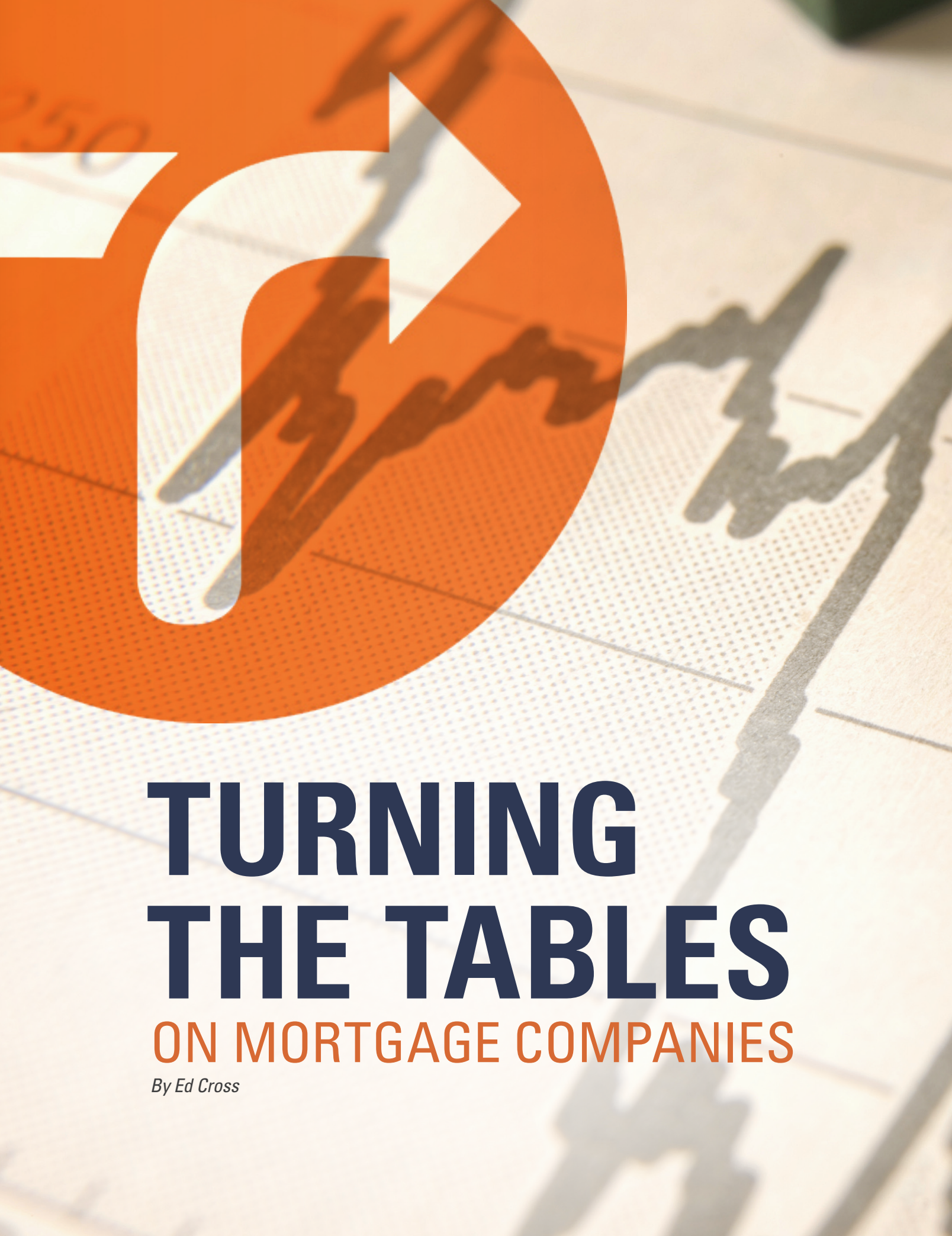

TURNING THE TABLES

ON MORTGAGE COMPANIES

By Ed Cross

RIA published an open letter to the mortgage industry penned by then-executive director, Tim Shaw. It was a no-holds-barred challenge to the industry to treat restorers with fairness and stop abusing power it acquired where "he who holds the money holds the power." It posed the question to the banks: "If you don't want us to get paid for restoring the property, please tell us where we can put the water back." I don't recall seeing a response from the mortgage industry. Maybe it simply got lost in the mail. In this author's opinion, the state of affairs has improved since then, but the problem continues to delay restorers' receivables.

First, a short review of basic concepts is in order. When a party purchases real property with borrowed funds, the party is mortgaging the property. The lender is the mortgagee and the borrower is mortgagor. The mortgagee records a deed of trust against the title, which is an encumbrance on the property and puts the mortgagee in a senior position to receive the proceeds of a future sale of the property. If the loan is not timely paid, the mortgagee can foreclose, which will typically wipe out junior liens, including mechanic's liens, in a process lovingly referred to as lien-stripping. Unbeknownst to many contractors, a mechanic's lien is merely a claim until it has been foreclosed upon (i.e., a court has adjudicated that the lien is valid, which is a very rare occurrence).

The property is the collateral for the loan required by the lender to make the loan. The mortgagee holds a legal and financial interest in the property. If the collateral is damaged, such as by fire or flood, the lender's protection is jeopardized, so buried in the fine print of the loan documents (which no normal humans ever read) is a provision stating that in the event of a casualty loss that damages the collateral,

> "As an assignee of the insurance proceeds, you are the legal owner of the money, as if you had stepped in the shoes of the insured borrower."

the insurance proceeds will be paid to the mortgagee. The borrower is unknowingly contractually bound to that provision. The problem is that the loan documents rarely specify any duties on behalf of the mortgagee to do the right thing with those funds. That's because there is unequal bargaining power in the transaction. I always tell my restorer clients never to tell their customers that the restoration contract is not negotiable because under certain circumstances, that could make it unenforceable. But do you think the lender will negotiate the fine print in loan documents when you are buying property? The mere thought of it is laughable. In any event, the term is there and even if it were unenforceable, checks for significant amounts of insurance loss proceeds are almost always made payable, at least jointly, to the mortgagee. The aggregate effect of this across thousands of losses in 50 states is that billions of dollars of funds intended for restorers are sitting in the coffers in undisclosed locations of massive bureaucratic financial institutions. Delaying the release of those funds to allow continued use of those funds by even one day allows a major financial advantage to the behemoth institution. Someone is earning money on that money. And it's not you.

Mortgagees have a complex set of procedures they insist on following before they release the funds to those who rightfully deserve them. Actually, their procedures are primarily a set of hoops for the restorer to jump through while the mortgagee sits back, shouting commands like a carnival barker, and watching how high the restorer will jump.

Unfortunately, the process for each company is different, so the restorer must incur the expense and downtime of re-learning the red tape for each mortgagee. The process can be labor-intensive and expensive, and that last time I checked, there is no line item charge in Xactimate for this service. I call it a "service" because the restorer is working to help the customer perform the customer's payment obligations under the contract. That's like making the customer extract water and then charging him for doing the work himself. And if you are not a squeaky wheel with the mortgagee, do you think you will ever see the money?

The best remedy, in my view, is to have the customer execute a strongly-worded irrevocable assignment of the insurance policy benefits, place the insurance company on formal notice of the assignment in hopes that you will be named on the check and maintain a cordial relationship with the customer and sweet-talk the customer into giving you the check rather than sending it to the mortgage company first. Then, have your lawyer send a firmly-worded letter to the mortgagee with a photocopy of the check. The letter requires execution by the mortgagee as a condition to release of the check to the mortgagee. If the mortgagee signs it, it forms a contract that requires the mortgagee to release the funds on your reasonable terms. The letter explains that if the mortgagee refuses to sign the contract, you will sue for a court order that the mortgagee endorse the check and surrender it to you without negotiating it and hanging it up for weeks allegedly waiting for it to "clear." So be reluctant to allow the mortgagee to take possession of the funds without some comfortable safeguards in place.

Some loan documents purport to allow the mortgagee to apply insurance loss proceeds to a past due balance on the loan. In other words, "If you owe me money, I will collect it wherever I can." Not so fast, Mr. Banker. Fortunately, the courts of many states have addressed this issue and decided that a contractor's contract rights trump a mortgagee's contract rights where the collateral has been repaired by the contractor. To allow otherwise would result in an unjust enrichment to the mortgagee, who seeks to enjoy the benefits of the work and the cash. That's a double-recovery. Although they mention unjust enrichment, California courts focus on equity in these cases, holding that the mortgagee is under an obligation implied in law and "imposed because good conscience dictates that under the circumstances the person benefitted should make reimbursement." Furthermore, what was a "used" building is now a "new" building, thanks to the industriousness of the contractor, so the collateral (and the bank's interest) has appreciated in value.

The first roadblock they throw out is the convenient excuse that they are not authorized to talk to you. This is easily remedied if you have the customer sign a professionally drafted mortgage information release and authorization. It irrevocably waives the customer's right of privacy regarding the status of the loan and disbursement of insurance loss proceeds and directs the mortgagee to tell you everything you want to know and send you copies of all the documents request. As assignee of the insurance proceeds, you are the legal owner of the money, as if you had stepped into the shoes of the insured borrower. Many insurance carriers and mortgagees still can't wrap their heads around the concept of the assignment and will simply deny its validity on grounds that their own rules prohibit them. But their rules are not the law, and the law of many states prohibit enforcement of anti-assignment clauses in insurance policies. Just because an insurance company writes something does not make it so.

Under the laws of many states, for a plaintiff to recover money for services performed, the circumstances must be such as to warrant the inference that it was the expectation of both parties during the time the services were rendered that the compensation should be made. But the mere right to compensation does not solve the problem. One of the

biggest problems in the restoration industry is establishing the amount of the compensation because the nature of the work does not always lend itself well to fixed-price contracts, even though many states require them for residential work. But for Pete's sake, at least get the customer's written commitment to a specific set of prices so you don't waste a bunch of money paying a lawyer to respond to comments like, "The contract is too uncertain to be enforceable because the customer never agreed to a schedule of values."

If you are the type who prefers to get paid without going to court, then I highly recommend reaching out to the mortgagee, giving it written notice that its collateral has been damaged (it probably did not know), sending a copy of your invoice and getting a detailed description of its insurance loss process. Provide photographs and robust documentation of the damage and the completed work, and a certificate of completion and satisfaction signed by the customer. "Your collateral was so thrashed and I made it so nice, at no cost to you." They should be grateful. Reward their gratitude by promptly recording a mechanic's lien, sending a copy of the recorded lien to the mortgagee, and explaining that you will foreclose on the lien in short order. The cover letter should include an explanation of the unjust enrichment concept written by a lawyer and supported with citations to the applicable legal authority in the jurisdiction where the work was performed. Neutralize each of their excuses as they arise, and then pester them until they pay. Escalate gradually after giving advance warning of each step of escalation. Do not bluff. Do everything you say you are going to do on or before the date you say you will do it. Select a member of your staff to gain expertise in this process; someone who likes to nag … and doesn't mind a little pain.

Good luck. RIA

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