1. Litton purchased a home in January 2006 for $250,000. At the time of the purchase, Litton granted Bank a mortgage on the home to secure a loan of $200,000 used by Litton to purchase the home. The term of the mortgage was 30 years, and the interest rate was 5%.

In July 2019, Litton’s home was damaged by fire (Litton was not at fault in any respect). The cost to repair the damage was $120,000 and the home was properly insured. At the time, the balance of the mortgage debt is approximately $144,500. Litton wants to use the insurance money to repair the damage to the home. Bank wants to apply it to reduce the mortgage debt, and also demands that Litton come up with an additional $24,500 more to pay off the entire balance of the debt. Bank argues that due to the fire, Bank can accelerate the maturity of the debt and demand immediate payment of the full balance of the debt. Irate, Litton sues Bank for a declaration that he is entitled to have the insurance monies made available to him to allow him to restore his home.

(a) What result if the note and mortgage are silent as to the rights of the parties?

(b) What result if the mortgage authorizes the Bank to apply casualty insurance proceeds to the mortgage debt?

(c) Can Bank also use the fire as a basis to accelerate the mortgage debt?

(d) What result under the Fannie/Freddie standard single-family residential deed of trust form we looked at in Week 2? [It is still available on the class website, or you can also find it on page 1442 in the Casebook, ¶¶ 5 and 11.]

(e) Why would a mortgage lender be reluctant to make insurance proceeds available for rebuilding, if the rebuilt home would be more than sufficient in terms of value to secure the unpaid balance of the debt?

2. Note 5 on page 466 highlights the “full credit bid rule” and its potential impact when the mortgaged premises is damaged by an insured casualty during the foreclosure process. In thinking about this issue, assume that Levin defaulted on his mortgage, which is held by Bank. Levin owed $200,000 on the mortgage debt. Bank began a foreclosure, and a foreclosure sale was scheduled for September 11. On September 11, the Bank showed up at the foreclosure sale and made a “credit bid” of $200,000 (i.e., Bank bid in the amount of its debt). Bank was the high bidder at the sale. After the sale, Bank learned that at 11:00 p.m. on September 10 (the evening before the sale), Levin’s house burned to the ground. Insurer is prepared to issue a check for $220,000, pursuant to the terms of the policy, for the damage to the home.

(a) Does Bank have any claim against the casualty insurance proceeds? Should it? Why
or why not?

(b) What implications does the “full credit bid” rule have for a foreclosing mortgagee in terms of its foreclosure policies?

3. Some questions on escrow requirements for interest and taxes:

(a) The insurance and taxes on a relatively modest home here in Boone County could be as much as $5,000 per year. RESPA then allows a two-month cushion as described in the reading ($5,000 x .167 = $835). This means that the mortgagee could require the Borrower to escrow, each month, an amount equal to one-twelfth of $5,835, or $486.25.

Under the Fannie/Freddie documents, Mortgagee does not have to pay interest to the Mortgagor on the balance that exists in the escrow account, unless the Mortgagor and Mortgagee have a contrary agreement or “Applicable Law requires interest to be paid on the Funds.” And as the book explains, federal regulations applicable to national banks and federally chartered thrift institutions pre-empt any state laws that would require the payment of interest on such escrow accounts. Is this pre-emption sound? [The effect of it is that Mortgagor is essentially making an interest-free loan to the Mortgagee (who has the use of the funds).] Federal pre-emption aside, should Missouri law require the payment of interest on deposits such as escrow deposits or tenant security deposits?

(b) The Fannie/Freddie uniform instrument allows Lender to waive the Borrower’s obligation to escrow sums for taxes and insurance. [DOT ¶ 3] Suppose that Bank has a mortgage on Smith’s home, and Smith wants Bank to waive the escrow requirement. Bank wants to keep Smith happy, because Smith owns several local businesses and maintains all of her business accounts with Bank. The DOT allows a waiver in writing. Should this waiver be unconditional? If not, what conditions should Bank place in the written waiver letter to protect Bank against the risks associated with nonpayment of taxes and/or insurance? [Be as specific as possible.]