

# Determining who is a borrower under a reverse mortgage

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As attorneys representing the financial services industry well know, the financial crisis of 2007-2008 resulted in a wave of foreclosures across the country as borrowers struggled to make payments on their mortgages.

The sudden increase in the volume of foreclosures required courts in many states to address an issue that had not been fully resolved or explained in more prosperous periods: How do you determine whether a lender (or the lender's representative) has standing to pursue the foreclosure?

However, during litigation over whether the party claiming a right to foreclose was the proper party, litigants rarely questioned whether the foreclosure was brought against the right borrower.

Lenders generally understood that the person who signed the promissory note evidencing the mortgage debt was the "borrower" for that loan. If the borrower co-owned the mortgaged property with another person, then each owner would execute the mortgage and each owner would be subject to a foreclosure action brought by the lender if the loan went into default.

Over the past few years, litigation over reverse mortgages has revealed that the analysis may not be so simple. Beginning with two decisions by the Florida 3rd District Court of Appeal, courts have identified a lack of clarity as to who is the "borrower" under a reverse mortgage instrument.

That determination has significant consequences: Under the terms of a reverse mortgage, the lender has the right to accelerate the debt and enforce its security interest against the mortgaged property upon the death of the "borrower."

## REVERSE MORTGAGE STRUCTURE AND INSURABILITY

A reverse mortgage is similar to a normal mortgage: It is a security interest on property that secures a borrower's obligation to repay a debt.

Unlike a normal or "forward" mortgage loan, reverse mortgages typically involve disbursement of loan proceeds over time from the lender to the borrower, and the borrower has no obligation to make regular monthly payments (aside from an obligation to pay taxes, insurance and community association assessments for the mortgaged property). Instead, there are specific events—most commonly, the death of the borrower — that trigger the borrower's obligation to repay the loan in full when they take place.

Most reverse mortgage loans are originated under a program insured by the Department of Housing and Urban Development through the Federal Housing Administration. These loans, called home equity conversion mortgages, or HECMs, are insured under federal law codified at 12 U.S.C.A. § 1715z-20 and are subject to HUD regulations.

The statute sets relatively strict eligibility requirements for obtaining an FHA-insurable reverse mortgage. To qualify, the borrower must be "an elderly homeowner," which is defined as "any homeowner who is at least 62 years of age."

The statute also expressly bans HUD from insuring any mortgage that would allow the lender to commence a foreclosure on the property while the non-borrowing spouse of the borrower remained alive and in possession:

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The Secretary may not insure a home equity conversion mortgage under this section unless such mortgage provides that the homeowner's obligation to satisfy the loan obligation is deferred until the homeowner's death, the sale of the home, or the occurrence of other events specified in regulations of the Secretary. *For purposes of this subsection, the term "homeowner" includes the spouse of a homeowner.*<sup>1</sup>

Until recently, however, HUD's regulations governing the insurability of reverse mortgages appeared inconsistent with the statutory requirements.

For example, while the statute requires that a reverse mortgage "provide ... that the homeowner's obligation to satisfy the loan obligation is deferred until the homeowner's death" (including the death of the homeowner's spouse) in order to be insurable, HUD regulations required that "the mortgage shall state that the mortgage balance will be due and payable in full if a mortgagor dies and the property is not the principal residence of at least one surviving mortgagor."<sup>2</sup>

The regulation further defined the "mortgagor" as "each original borrower under a mortgage."<sup>3</sup>

Accordingly, under HUD's regulations a reverse mortgage would not be insurable if it allowed a spouse who was not a "borrower" to

remain in the property following the death of the borrowing spouse. Lenders generally complied with the HUD regulations by using HUD-promulgated forms that were designed to allow the lender to accelerate the balance of the loan and foreclose upon the death of the borrower, even if the non-borrowing spouse still lived in the residence.

### TENSION CULMINATES IN *BENNETT V. DONOVAN*

In 2011 the tension between HUD's regulatory requirement that HECMs become "due and payable in full" upon the death of the last eligible borrower and the statutory mandate that HUD insure HECM products designed to protect a homeowner's right to remain in the property resulted in litigation.

Three surviving spouses of deceased individuals who had entered into HECMs sued the secretary of HUD in his official capacity in the U.S. District Court for the District of Columbia, alleging that regulations implementing the federal HECM insurance program violated the Administrative Procedure Act, 5 U.S.C.A. § 551.

The HECMs at issue contained language from the HECM form contract in effect at the time the loans were entered into and permitted the lender to demand immediate payment on the loan if the "borrower dies and the property is not the principal residence of a least one surviving borrower."

The surviving spouses alleged that this language — which was required under 24 C.F.R. § 206.27(c)(1) — conflicted with the language in 12 U.S.C.A. § 1715z-20(j) prohibiting HUD from insuring products that did not protect a "homeowner" from foreclosure until the homeowner's death.

After the District Court's initial order dismissing the case was reversed on appeal, the court granted summary judgment to the plaintiffs on the grounds that HUD violated 12 U.S.C. § 1715z-20(j) by insuring HECMs that failed to protect the rights of non-borrowing surviving spouses. *Bennett v. Donovan*, 4 F. Supp. 3d 5 (D.D.C. 2013).

The District Court emphasized that the only plausible construction of subsection (j) was that "the loan obligation [should be] deferred until the homeowner's and the spouse's death." Accordingly, the court remanded the case to HUD to fashion appropriate relief.<sup>4</sup>

### THE MISUNDERSTOOD IMPACT OF *BENNETT*

Although *Bennett* effectively resolved the discrepancy between the statute and the HUD regulations on a go-forward basis, it did not provide guidance about the impact of the discrepancy for the numerous reverse mortgage loans originated using the HUD forms that stated the lender would be entitled to foreclose upon the death of the "borrower" (understood to mean the person who applied for the loan and signed the promissory note).

In such foreclosure actions, the non-borrowing spouses began raising arguments that they were entitled to stay in

the residence following the deaths of their spouses because Congress intended to grant that right when it conditioned the insurability of the reverse mortgage loan upon it.

In March 2016, the Florida 3rd District Court of Appeal issued the first significant appellate decision on the non-borrowing spouse issue in *Smith v. Reverse Mortgage Solutions*, 200 So. 3d 221 (Fla. 3d Dist. Ct. App. 2016). Kenneth Smith executed the promissory note evidencing a reverse mortgage loan, but he and his wife both executed the mortgage providing the security interest for the loan on signature lines labeled "borrower."

After Kenneth Smith died, the lender brought a foreclosure action, claiming that he was the sole "borrower" under the mortgage, and thus after his death, "the property [was] not the principal residence of at least one surviving borrower."

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Under a reverse mortgage the loan proceeds are typically disbursed over time from the lender to the borrower, while the borrower has no obligation to make regular monthly payments.

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Although the trial court granted a final judgment of foreclosure in favor of the lender, the Court of Appeal reversed. The court first looked at the language of the mortgage and concluded that the definition of "borrower" was unambiguous, and that the signature line labeled "borrower" on which Smith's wife signed was a clear indication of her status as a borrower.

However, the court then strayed from a straightforward question of interpretation of the mortgage into a misguided analysis of the impact of the relevant federal statute concerning the insurability of the reverse mortgage loan.

The *Smith* court looked to 12 U.S.C.A. § 1715z-20(j) and concluded that Congress had unambiguously expressed its intent that a reverse mortgage loan insured by HUD would contain protections for the non-borrowing spouse following the death of the borrower.

"Against the backdrop of this unambiguous congressional mandate," the court reasoned, "it would be difficult, if not impossible, for us to construe Mrs. Smith as anything other than a 'borrower.'"

In concluding that the congressional mandate in 12 U.S.C.A. § 1715z-20(j) provided clear guidance for the interpretation of the term "borrower" in the mortgage, however, the *Smith* court did not address two obvious questions.

First, while the court may have correctly observed that Congress apparently intended for insurable reverse mortgage loans to contain provisions protecting a non-borrowing spouse from foreclosure, what about the express directive from HUD in 24 C.F.R. § 206.27(c)(1) to require mortgagees to foreclose on a non-borrowing spouse after the death of the borrower?

Even if 24 C.F.R. § 206.27(c)(1) ran contrary to congressional intent, no court had held that it was void ab initio. Accordingly, it would seem to be just as relevant to the interpretation of the mortgage at issue in *Smith* as the statute.

Non-borrowing spouses began raising arguments that they were entitled to stay in the property following the deaths of their spouses because Congress intended to grant that right when it conditioned the insurability of the reverse mortgage loan upon it.

Second, and more fundamentally, the *Smith* court did not address why the interpretation of a statute governing insurability of reverse mortgage loans was even relevant to the question before it: Does the specific mortgage at issue allow foreclosure against the non-borrowing spouse? The insurability of the loan was an issue between the lender and HUD; it had nothing to do with whether the mortgage provided the lender the right to proceed to foreclosure.

Despite the holding in *Smith* (and the later holding in *Edwards v. Reverse Mortgage Solutions Inc.*, 187 So. 3d 895 [Fla. 3d Dist. Ct. App. 2016]), which applied the reasoning from *Smith* to hold that a lender could not foreclose on a reverse mortgage while the borrower's spouse continued to live in the property), other courts took a closer look at the actual language used in those instruments and concluded that the non-borrowing spouse did not have an absolute right.

For example, in *Nationstar Mortgage Co. v. Levine*, 216 So. 3d 711 (Fla. 4th Dist. Ct. App. 2017), the Fourth District Court of Appeal rejected the non-borrowing spouse's argument that the circuit court was bound by the holdings in *Smith* and *Edwards*.

Instead, it held that the mortgage and loan agreement contained "patent ambiguities" regarding whether the wife was actually a "borrower," and that the circuit court should have conducted an evidentiary hearing to consider the other evidence.

Similarly, in *Estate of Jones v. Live Well Financial Inc.*, No. 17-cv-3105, 2017 WL 4176661 (N.D. Ga. Sept. 20, 2017), a non-borrowing spouse argued that, based on the *Bennett* decision, the holder of the HECM could not proceed with a foreclosure on her residence because federal law required HUD to ensure that the non-borrowing spouse would not be subjected to foreclosure when the borrower died.

The U.S. District Court for the Northern District of Georgia correctly recognized that the argument that federal law prohibits a lender from enforcing a reverse mortgage against a non-borrowing spouse was a red herring:

Whether the reverse mortgage here is insurable by HUD is not at issue. Instead, the enforceability of the terms of the reverse mortgage are at issue. *Bennett v. Donovan* simply addressed the validity of a HUD regulation implementing the mortgage-insurance program. Therefore, it is not relevant.<sup>5</sup>

### PALMERO: NUANCES AND THE NON-BORROWING SPOUSE

In April 2018, the Florida 3rd District Court of Appeal appeared to recognize the far-reaching impact of its decisions in *Smith* and *Edwards* and issued a new decision in *OneWest Bank FSB v. Palmero*, No. 3D14-3114, 2018 WL 1832326 (Fla. 3d Dist. Ct. App. Apr. 18, 2018). This decision presented a more detailed analysis as to whether a non-borrowing spouse qualified as a "borrower" under the terms of a reverse mortgage.

In *Palmero* the lender brought a foreclosure action against Luisa Palmero, claiming that her deceased husband, Roberto, had taken out a reverse mortgage and his death triggered the right to accelerate the mortgage debt and commence foreclosure proceedings.

The Palmeros executed the mortgage on separate signature lines underneath the statement "BY SIGNING BELOW, Borrower accepts and agrees to the terms contained in this Security Instrument and in any rider(s) executed by borrower and recorded with it."

However, only Roberto Palmero signed the promissory note evidencing the payment obligation associated with the reverse mortgage. Further, only Roberto Palmero was named as the borrower in the loan application and loan agreement, and Luisa Palmero executed a "non-borrower spouse ownership interest certification" in which she certified that "should [her] spouse predecease [her] ... and unless another means of repayment [was] obtained, the home where [she] reside[s] may need to be sold to repay reverse mortgage debt incurred by [her] spouse."

After trial, the Circuit Court granted judgment in favor of Luisa Palmero, concluding that she was not a "borrower" under the terms of the mortgage and thus Roberto Palmero's death triggered acceleration of the loan, but federal law prevented the lender from foreclosing on the property while Luisa Palmero, the non-borrowing spouse, remained alive.

The Court of Appeal affirmed the lower court's holding that Luisa Palmero was not a "borrower," saying it was required to read all of the documents executed at the origination of the reverse mortgage together.<sup>6</sup>

The court determined that reading the definition of "borrower" in the mortgage, along with the loan application executed by the husband, the promissory note he executed and the non-borrower spouse certification executed by his wife, made it clear that she was not a "borrower" under the reverse mortgage.

As the court stated, "To the extent there was any confusion or inconsistency in the mortgage, it was cleared up by the note, loan application, loan agreement, and non-borrower spouse certification, which unequivocally provided that Mrs. Palmero was not the borrower for the reverse mortgage and defined Mr. Palmero as the borrower."

As a result, the court reversed the circuit court's judgment and remanded the case with instructions to enter a judgment of foreclosure in favor of the lender.

The court further distinguished the facts before it from the facts that were before it when it decided *Smith* and *Edwards*. Specifically, the court held that *Smith* and *Edwards* were not controlling in light of the material factual distinctions in the case.

As the *Palmero* court explained, “In *Smith* and *Edwards*, the court had a limited record, and didn’t have these contemporaneously signed documents, when it decided that the surviving spouses in those cases were borrowers.”

### INTERPRETING REVERSE MORTGAGE LOANS AFTER PALMERO

In *Palmero*, the Court of Appeal recognized the correct way for a court to interpret a reverse mortgage in the context of the conflicting directives from HUD and Congress as to the insurability of those loans.

In short, the insurability of the loan is not the question before the court — instead, the narrow question presented in a reverse mortgage foreclosure case is whether the governing loan documents define the “borrower” as including a non-borrowing spouse for the purposes of the acceleration clause under which the lender purports to foreclose.

If the loan documents are ambiguous, the court should look to other documents executed contemporaneously with the origination of the loan, including the promissory note, the loan application and any certifications by the non-borrowing spouse acknowledging his or her status as a non-borrower and the possibility that the death of the borrower could lead to foreclosure.

The clarity offered by the *Palmero* opinion is a welcome guide to navigating the tricky issues posed by reverse mortgage foreclosures and promises to provide a blueprint for those cases in the years to come.

### NOTES

<sup>1</sup> 12 U.S.C.A. § 1715z–20(j) (emphasis added).

<sup>2</sup> 24 C.F.R. § 206.27(c) (2016).

<sup>3</sup> *Id.* at § 206.3 (emphasis added).

<sup>4</sup> After the District Court’s ruling in *Bennett*, HUD developed a program called the Mortgagee Optional Election. The program allows for the deferral of foreclosure on a surviving non-borrowing spouse following the borrower’s death. See generally U.S. DEP’T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2015–15 (2015), <https://bit.ly/2KPen5F>.

<sup>5</sup> See also *Fed. Nat’l Mortg. Ass’n v. Takas*, No. 17-cv-204, 2017 WL 3016785, at \*5 (D. Utah July 14, 2017) (concluding that 12 U.S.C. § 1715z–20(j) “is inapplicable to the validity or enforceability of [the borrower’s] reverse mortgage”); *Nationstar Mortg. LLC v. Goeke*, 57 N.Y.S.3d 223, 225–26 (N.Y. App. Div. 2017) (rejecting argument that federal law barred foreclosure of HECM against non-borrowing spouse and holding that trial court erred in granting summary judgment in favor of non-borrowing spouse in light of

indications that only husband applied for loan and only husband executed promissory note); *Washington-Jarmon v. OneWest Bank FSB*, 513 S.W.3d 103 (Tex. App. – Houston, Nov. 22, 2016) (affirming summary judgment against the non-borrowing spouse on a HECM based on evidence that only husband applied for the loan, signed the loan agreement, and executed the note, and wife executed ownership interest certification acknowledging her status as a non-borrowing spouse); *Nationstar Mortg. LLC v. Carey*, C.A. No. 9274-MA, 2014 WK 6735445 (Del. Ch. Nov. 26, 2014) (recommending that summary judgment be entered in favor of HECM mortgage holder and rejecting argument that federal law provided non-borrowing spouse a right to remain in the property), *recommendation accepted and judgment entered*, *Nationstar Mortg. LLC v. Carey*, No. 9274-MA, 2014 WL 7149146 (Dec. 15, 2014) (order granting summary judgment).

<sup>6</sup> Citing *Sardon Found. v. New Horizons Serv. Dogs Inc.*, 852 So. 2d 416, 420 (Fla. 5th Dist. Ct. App. 2003).

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