SB 199

Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 199 (Senators Frosh and Klausmeier)
Judicial Proceedings Environmental Matters

Real Property - Refinance Mortgage - Priority over Junior Liens

This bill authorizes a mortgagor or grantor to refinance the full amount of the unpaid indebtedness secured by a first mortgage or deed of trust on residential property for a lower interest rate than provided for in the evidence of indebtedness secured by the first mortgage or deed of trust without the permission of the holder of a junior lien, as defined by the bill, if (1) the principal amount secured by the junior lien does not exceed $150,000 and (2) the principal amount secured by the refinance mortgage does not exceed the unpaid outstanding principal balance of the first mortgage or deed of trust plus an amount to pay closing costs of up to $5,000.

The bill applies prospectively and does not apply to a refinance mortgage recorded or having an effective date before the bill's October 1, 2013 effective date.

Fiscal Summary

State Effect: Special fund revenues decrease by $47,700 in FY 2014, which accounts for the bill's October 1, 2013 effective date, as a result of the inability to collect interest and principal payments on Downpayment and Settlement Loan Program (DSELP) loans held by the Department of Housing and Community Development (DHCD). Special fund revenues decrease in future years to reflect foregone interest and delayed principal payments on additional DSELP loans. Special fund expenditures increase by $5,400 in FY 2014, which accounts for the bill's effective date, due to DSELP servicing costs. Future year special fund expenditures increase to reflect servicing costs on additional DSELP loans.

(in dollars)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
SF Revenue	($47,700)	($111,400)	($175,000)	($238,600)	($301,000)
SF Expenditure	$5,400	$12,600	$19,800	$27,000	$34,200
Net Effect	($53,100)	($124,000)	($194,800)	($265,600)	($335,200)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: The bill does not directly affect local governmental operations or finances.

Small Business Effect: Minimal.

Analysis

Bill Summary: If the refinance mortgage meets these conditions, the bill grants, on recordation, the same lien priority to the refinance mortgage as the replaced first mortgage or deed of trust and requires the refinance mortgage to contain a specified notice. The bill clarifies that the priorities of two or more junior liens are governed by Title 3 of the Real Property Article. The bill's provisions do not preempt or abrogate the operation or effect of, or ability of a court to apply the principles of, equitable subrogation or equitable subordination.

Current Law/Background: According to the Federal Reserve Bank of Philadelphia, 23.5% of homes in the United States had more than one mortgage in 2012. In Maryland, a valid deed or other instrument, including a mortgage or deed of trust (hereafter "mortgage"), that is properly recorded takes priority over a subsequent deed, unless the subsequent grantee accepted the deed in good faith, without constructive notice, and in return for good and valuable consideration and recorded the deed first. Essentially, a mortgage recorded earlier is granted priority over subsequent mortgages which become junior in status. Once priority is determined, it can only be altered by a subordination agreement that reestablishes priorities between lenders.

A refinanced mortgage is the repayment of an existing mortgage loan with funds from a new loan using the same property as security. Often, the refinancing of a mortgage can help a homeowner achieve better loan terms, such as lower interest rates. A lender may not refinance a loan more often than (1) once every 12 months and (2) twice in a five-year period. Because a refinanced mortgage is a new mortgage, when a first mortgage is refinanced, the holder of an existing junior mortgage is asked to agree to subordinate so that the first loan holder preserves priority. However, the holder of a junior mortgage can refuse to sign the subordination agreement and, thus, block the homeowner's ability to refinance the first mortgage. Even if lenders sign a subordination agreement, it can take more than a month to approve a request and refinancing homeowners can be required to pay fees to process a subordination request and to lock in refinanced interest rates.

Case law has established a legal principle that eliminates the need for a subordination agreement in specified situations. This principle, known as equitable subrogation, holds that a refinanced mortgage inherits the priority of the mortgage it replaces. This rule applies only to situations in which the subrogation does not disadvantage the holder of the junior mortgage. The holder of the junior mortgage is disadvantaged if the refinanced mortgage has a higher principal amount or interest rate or a longer time to maturity than the extinguished mortgage. Equitable subrogation removes the need for a subordination agreement and, therefore, the ability of the holder of the junior mortgage to block the refinancing. This doctrine applies in Maryland as long as the refinancing lender had no actual knowledge of the junior loan. *See Citibank F.S.B. v. New Plan Realty Trust*, 131 Md. App. 44, 60-61 (Md. Ct. Spec. App. 2000.

This bill is similar to a Virginia law enacted in 2000 and amended most recently in 2011.

State Revenues: Special fund revenues decrease by $47,729 in fiscal 2014, due to the bill's October 1, 2013 effective date, to account for the inability of DHCD to collect interest payments on DSELP loans.

Individuals who use a Community Development Administration (CDA) mortgage from DHCD to purchase a home, such as the Maryland Mortgage Program, may qualify for a nonforgivable DSELP loan of up to $5,000, at 0% interest until repayable, to assist with down payment and closing costs. A DSELP loan is held in a junior position. The loan is repayable upon the payoff or refinancing of the first mortgage or upon the sale or transfer of the home, at which time interest begins to accrue. Generally, when a home is sold, the borrower uses a lump sum to pay off the DSELP loan and avoid interest charges.

In the event the homeowner chooses to refinance his or her home, DHCD currently only agrees to subordinate the DSELP loan if the homeowner begins to make payments on the DSELP loan. As noted above, once a DSELP loan is in repayment, DHCD charges an interest rate. Under the bill, DHCD would be prohibited from requiring payments on the DSELP loan if the homeowner refinances a first CDA mortgage. However, because DSELP loans are nonforgivable, DHCD will still eventually collect on the loan's *principal* when the homeowner sells the property or pays off the mortgage but not the *interest*. The exact timing of the collection cannot be estimated.

DHCD estimates that 100 homeowners with a CDA first mortgage and a DSELP loan agreed to refinance the first mortgage in calendar 2012. This is a relatively high number of refinanced first mortgages, due to low interest rates on mortgages. While DHCD expects this number to remain high for the foreseeable future, the number of refinanced mortgages may decrease if mortgage interest rates increase. This estimate assumes that 100 homeowners with a CDA first mortgage refinance under the bill's provisions annually. DHCD further advises that the average interest rate for a DSELP loan in repayment is 5%. Assuming each DSELP loan is for the maximum of $5,000, **Exhibit 1** shows the special fund revenue from interest that would be foregone and principal payments that would be delayed in fiscal 2014 through 2018.

Exhibit 1
Foregone Interest and Delayed Principal Payments on DSELP Loans
Fiscal 2014-2018

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Interest Payments	$18,262	$40,857	$61,351	$79,639	$94,366
Principal Payments	29,467	70,512	113,657	159,009	206,681
Total	**$47,729**	**$111,369**	**$175,008**	**$238,647**	**$301,048**

Source: Department of Housing and Community Development

State Expenditures: Special fund expenditures increase by $5,400 in fiscal 2014, due to the bill's October 1, 2013 effective date, to account for servicing costs of $72 per loan. If CDA mortgages continue to be refinanced at the current rate, special fund expenditures increase by an additional $7,200 each year due to the cumulative impact.

Additional Information

Prior Introductions: None.

Cross File: HB 88 (Delegate Arora, *et al.*) - Environmental Matters.

Information Source(s): State Department of Assessments and Taxation; Office of the Attorney General; Department of Housing and Community Development; Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Virginia Code; Federal Reserve Bank of Philadelphia; www.bankrate.com; Department of Legislative Services

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