

WFG Underwriting Bulletin



To: All WFG Policy-Issuing Agents; All WFG Title Examiners and Officers

From: WFG Underwriting Department

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Subject: Insuring All Inclusive Trust Deeds / Wrap-Around Mortgages

People are asking more questions about “Wrap-Around Mortgages” and “All Inclusive Trust Deeds” (referred to herein as a “Wrap Mortgage”). These terms generally refer to structures in which:

- the buyer makes a single payment for both mortgages to the seller and depends on the seller to pay the First Mortgage and accurately account for the payments on the seller carryback mortgage; or
- the buyer pays the First Mortgage holder directly and makes a separate payment on the carryback.

But the existing First Mortgage remains in place, and the Seller continues making payments on the unpaid First Mortgage.

This is to be distinguished from scenarios in which the Buyer formally assumes the First Mortgage and the Seller is released from further obligation on the First Mortgage. As you would expect, the assumption and release of liability dramatically changes the risk factors for both the Buyer and Seller. As a general rule, most USDA, VA and FHA mortgages are assumable, subject to conditions, including that the Buyer/new borrower meet the loan’s eligibility requirements.

Most institutional mortgages, including those sold to or backed by Fannie Mae or Freddie Mac, are NOT assumable without the agreement of the Servicer. To determine which you have, review the mortgage language. You are looking for either an assumption clause or a due on sale/due on transfer clause.¹

From long experience, we know that Wrap Mortgages subject to a Due-on-Sale clause rarely close, are often a lot of extra work, and carry extra risks for the Buyer and Seller, the real estate broker and title agent.

¹ The due on transfer provisions are usually found in Section 18 in Uniform Covenants of the Fannie/Freddie Forms.

Why are Wrap Mortgages Proposed?

There are a number of arguments given as to why Buyers and Sellers should consider a Wrap Mortgage. Those include:

- Making your home more marketable in a soft real estate market
- Passing the benefit of the Seller's lower rate financing to the Buyer, or to make a "profit" from the difference in the interest rate charged on the wrap-mortgage and the rate charged on the underlying mortgage.
- The existing mortgage provides built in financing for more, sometimes all, of the purchase price.
- Expands your market to include Buyers who otherwise wouldn't qualify for a traditional mortgage or can't come up with the required down-payment.

But there are significant downsides for both the Buyer and Seller in a Wrap Mortgage transaction, and this is certainly not a comprehensive list.

Risks to the Parties

While WFG wants its policy issuing agents to understand the business risks being considered by their customers, **THIS BULLETIN DOES NOT CONSTITUTE LEGAL ADVICE TO THE BUYER OR SELLER. THE PARTIES ARE STRONGLY ADVISED TO CONSULT WITH THEIR ATTORNEYS.**

- **Due on Sale Risk.**

Where the First Mortgage includes a "Due on Sale" clause, the lender can call the loan immediately and start foreclosure. A foreclosure not only causes the Buyer to lose the property and any equity they may have in the property, but leaves the Buyer still liable on the promissory note secured by the Wrap Mortgage.

A foreclosure is equally bad for the Seller. There is no way to "cure" a due on sale violation so reinstatement will rarely be permitted. The foreclosure will wipe out the second priority Wrap Mortgage, and the Seller's "equity" in the property, unless the Seller makes the difficult decision to pay off the First Mortgage.

- **Failure of the Seller to Make Payments.**

The Buyer is relying on the Seller to make all the payments due on the underlying First Mortgage. If the Seller doesn't, for whatever reason, that First Mortgage will get foreclosed to the detriment of the Buyer.

There are ways to mitigate some of this risk which should be discussed with legal counsel.

- **Bankruptcy of the Buyer or Seller**

All sorts of unexpected things can happen if either the Buyer or Seller files bankruptcy.

- **Impact on Seller's Credit**

There are two aspects to this. If the Buyer fails to make payments, the Seller is still liable on the First Mortgage debt and must make the difficult choice between using their own money to make payments

on behalf of the Buyer or having their credit take a hit, and losing any equity they had in the “Wrap Mortgage.”

The second aspect is that the First Mortgage debt will still continue to show as outstanding on the Seller’s credit report until it has been paid in full. This may make it more difficult for the Seller to qualify for future mortgages and loans – even with the income stream from the Wrap Mortgage.

In many states, the Seller can be held liable for any deficiency should a foreclosure not generate sufficient funds to pay off the First Mortgage. A deficiency judgment not only hits the Seller’s credit, but their pocketbook.

- **Duties under the First Mortgage**

Even when the First Mortgage is not assumed, the Buyer is functionally responsible for complying with the non-monetary terms of the First Mortgage, as those can also trigger foreclosure. It must keep the property insured, maintained, taxes paid, deal with homeowners’ association requirements and payments and the like.

Even though they no longer own the property, the Seller is still contractually obligated to comply with the non-monetary terms of the First Mortgage. If there are barriers delaying foreclosure (such as Bankruptcy or a foreclosure moratorium), the lender can still enforce these duties against the Seller.

- **Difficulties when it’s Time to Sell or Refinance**

Privacy laws being what they are, when the Buyer is ready to sell or refinance, the Buyer may have difficulty getting a payoff statement for the First Mortgage without the active involvement of the Seller.

- **Additional Attorney’s Fees and Closing Costs**

A Wrap-Mortgage is not a standard boilerplate document. Done right, it is a complex and carefully negotiated set of documents, with significant tax consequences. A non-attorney real estate agent, title agent, or escrow officer, simply lack the specialized expertise necessary to properly advise either party on the factors to be considered, or to draft the necessary documentation. Thus attorneys’ fees and ideally those of a tax advisor should be factored into the anticipated costs for both parties.

- **Tax Issues**

The Buyer’s ability to deduct interest paid on the Wrap Mortgage may be lost if the Wrap Mortgage isn’t properly perfected by the Seller, or otherwise not treated as secured debt for tax purposes. The Buyer’s ability to write-off interest paid on the Wrap Mortgage may be impacted by the failure of the Seller to provide required tax forms.

The Seller usually wants to treat the sale with a Wrap Mortgage as an “installment sale” for tax purposes, meaning they only recognize their gain on the sale as they receive the payments under the Wrap Mortgage. However a poorly drafted Wrap Mortgage package which contains (or can be recharacterized as) an “assumption” of the First Mortgage, can trigger immediate taxation of gain in the year of sale. If the Seller took depreciation deductions against the property, the Seller must report depreciation recapture income in the year of sale, whether or not an installment payment was received that year.

These and other tax considerations are discussed in IRS Publication 936.

https://www.irs.gov/publications/p936#en_US_2022_publink1000229896 and IRS Publication 537 https://www.irs.gov/publications/p537#en_US_2022_publink1000221646

Good tax counsel through the life of the Wrap Mortgage is critical for both parties.

- **All of the other Risks and Responsibilities of Holding a Mortgage**

The Seller has all of the other risks and responsibilities of holding a mortgage and processing the payments, including the bad debt risk, the risks of being pre-paid and losing the anticipated revenue stream, a duty to provide periodic accountings and annual tax forms.

Downsides to the Real Estate Agent and Title Agent

- **More Difficult to Get to Closing**

Wrap Mortgage transactions are more complex, more risky, more work, and simply have more moving parts that can cause your transaction to fall apart.

- **You will be Blamed, and your E&O may not Cover It**

When a Wrap Mortgage structure has been recommended by the real estate agent or title agent and one of the many potential problems comes about, whoever recommended it will be blamed and suffer the attendant reputational damage and potential civil suit. Because tax guidance and other risks are so far outside of the “regular” real estate practice, your E&O carrier may deny coverage.

How WFG is Managing Its Risk Protecting the Settlement Agent from Blame

With so many things that can go wrong in a Wrap Mortgage, whoever recommended the structure and whoever closed should expect to be blamed if things go wrong. Even though the Escrow and Settlement Services provided by WFG agents are not within the scope of our Agency Agreement, we thought we should share the procedures WFG has adopted internally to mitigate the Wrap Mortgage blame for our direct operations in Western States, and share the forms we use.

Those are as follows:

1. Determine immediately if the First Mortgage is assumable or not, and whether it contains a “due on sale” clause, and advise both Buyer and Seller.
2. If it is assumable, ask both if they want to pursue an assumption and release of liability, and of any additional charges we would make if we were to facilitate that process.² Document having done so.
3. Advise both Buyer and Seller in writing that both parties are STRONGLY ENCOURAGED to consult their legal counsel and tax advisors about the pros and cons of a Wrap Mortgage transaction.
4. Because Wrap Mortgages are complicated, non- standard documents, WFG will not prepare any Wrap Mortgage documentation or negotiate the terms of the transaction. All documents for the Wrap Mortgage must be prepared by legal counsel for either Buyer or Seller.

² Note that some states closely regulate escrow and settlement fees, and WFG has not filed a separate fee for facilitating Wrap Mortgage transactions. Agents in such states should consult their own rate filings.

- Advise Buyer, Seller and their real estate agents that WFG underwriting department has identified many things that can go wrong with a Wrap Mortgage, and that both parties will be asked to sign an Acknowledgement and [Hold Harmless Agreement](#) at closing. You may provide a copy of this bulletin if more detail is requested.

Requirements for Insuring a Wrap Mortgage

In contrast to managing the extra work involved on the settlement side, insuring a sale involving a Wrap Mortgage is not particularly difficult. Note that some of the requirement language is based on WFG's internal requirements, which not every agent may choose to adopt.

To the commitment for the Wrap Mortgage transaction, add the exceptions appropriate to the transaction from those shown below for the respective policies and add this requirement:

Execution, delivery, and recording of a [Wrap Around Mortgage /All Inclusive Deed of Trust], prepared by legal counsel for one of the parties.

Execution and delivery by Seller and Buyer, and any planned assignee of the proposed Insured Mortgage of an acknowledgement and hold-harmless agreement regarding the risks and uncertainties of a [Wrap-Around Mortgage/All Inclusive Deed of Trust] arrangement.

The Owner's Policy insuring the Buyer with a Wrap Mortgage will include the following Exceptions

- The First Mortgage is to be shown as an exception in the policy

[Mortgage/Deed of Trust] given by _____ to _____, recorded in Book _____, Page _____, and/or Instrument No. _____ [, as assigned to _____, assignee, by assignment recorded _____, in Book _____, Page _____, and/or Instrument No. _____].

- The Wrap-Around Mortgage is to be shown as an exception in the policy, followed by exceptions specifically addressing known risks:

[Wrap-Around Mortgage/All Inclusive Deed of Trust] given by _____ to _____, recorded in Book _____, Page _____, and/or Instrument No. _____ [, as assigned to _____, assignee, by assignment recorded _____, in Book _____, Page _____, and/or Instrument No. _____].

Any consequence, loss or damage arising from the failure to obtain consent to the sale of the property and the [Wrap-Around Mortgage/All Inclusive Deed of Trust] described in exception _____ from the holder of [Mortgage/Deed of Trust] recorded on _____, in Book _____ Page _____ and/or Instrument No. _____, including without limitation the exercise of any "due on sale" clause or prohibition on transfer, assumption, or subordinate financing.

Any consequence, loss or damage arising from the failure of the holder of the [Wrap-Around Mortgage/All Inclusive Deed of Trust] to make any or all payments under the first mortgage described in exception _____.

The loan policy insuring the Wrap Mortgage will include the following exceptions

1. The First Mortgage is to be shown as an exception in the policy

[Mortgage/Deed of Trust] given by _____ to _____, , recorded in Book _____, Page _____, and/or Instrument No. _____ [, as assigned to _____, assignee, by assignment recorded _____, in Book _____, Page _____, and/or Instrument No. _____].

2. Because the Wrap-Around Mortgage is what is being insured, no exception is required for it, but add this limitation on liability immediately after the exception for the First Mortgage.

The indebtedness(es) secured by the lien(s) described above is(are) included in the indebtedness secured by the Insured Mortgage, and the liability of the Company hereunder is limited to the amount secured by the Insured Mortgage less the amount(s) due and owing on the indebtedness(es) secured by the lien(s) described above.

3. When the Wrap-Around Mortgage is made without the written consent of the lienholders,

Any consequence, loss or damage arising from the failure to obtain consent to the sale of the property and the grant of the Insured Mortgage from the holder of [Mortgage/Deed of Trust] recorded on _____, in Book _____ Page _____ and/or Instrument No. _____, including without limitation the exercise of any "due on sale" clause or prohibition on transfer, assumption or subordinate financing.

4. *Any consequence, loss or damage arising from the failure of the holder of the [Wrap-Around Mortgage/All Inclusive Deed of Trust] to make any or all payments under the first mortgage described in exception _____.*

Consider Getting Lender Approval for an Assumption

Many of these downsides and risks are eliminated if the Buyer obtains approval for an Assumption of the existing First Mortgage and release of the Seller. As noted in the footnotes above, most government mortgages (FHA, VA, USDA) are assumable. Most servicers have a process for evaluating assumption requests. Then, instead of a Wrap Mortgage, the Seller can consider providing a traditional second mortgage loan.

Releasing a Wrap Mortgage

Remember that a Wrap Mortgage is really two separate mortgages even though the payoff statement for the Wrap Mortgage includes the amount of both debts and should include details on the underlying mortgage. Even though it should be set forth in the payoff statement for the Wrap Mortgage, as agent you should obtain a separate payoff statement directly from the holder of the First Mortgage and obtain and record two satisfactions or reconveyances – one for each mortgage.

State Law Differences

Some states do have different or additional requirements for a Wrap Mortgage. This bulletin may be supplemented by specific state bulletins. One has previously been issued in Texas under [TX 2023-07](#).

NOTE: This Bulletin should not be interpreted as reflecting negatively upon the character of an individual or entity mentioned herein and is for the sole purpose of establishing underwriting positions and policies reflecting WFG National Title Insurance Company's best business judgment. The information contained in this Bulletin is intended solely for the use of employees of WFG National Title Insurance Company, its title insurance agents and approved attorneys. Disclosure to any other person is expressly prohibited unless approved in writing by the WFG National Title Insurance Company's Underwriting Department.

The Agent may be held responsible for any loss sustained as a result of the failure to follow the standards set forth above.