

OPERATIONS GUIDE
MORTGAGE SUBORDINATION REQUESTS

INTRODUCTION

Credit Unions make many second mortgage loans and, accordingly, they frequently receive requests from the borrower to subordinate the Credit Union's mortgage. Subordination is necessary, if a member who has a second mortgage with the Credit Union wishes to refinance their first mortgage; the first mortgage lender will require the Credit Union to subordinate to the new first mortgage. This Operations Guide is designed to assist the Credit Union in understanding the issues involved with mortgage subordination requests and includes recommendations to expedite the subordination process at the Credit Union.

The primary issue in a subordination request is ensuring that the Credit Union is not adversely affected by the subordination. This involves determining the amount of the new mortgage and comparing it to the existing balance on the member's current first mortgage. The Credit Union should not agree to a subordination request in which the new first mortgage will exceed the loan balance of the existing second mortgage unless the Credit Union is satisfied that there is sufficient equity in the property to protect the Credit Union in the event it was necessary to foreclose on the Credit Union's mortgage at a later date.

The Credit Union is under no obligation to agree to subordinate but usually there is no reason not to cooperate with the member. There is no law or regulation that sets forth the procedure which must be followed by the Credit Union when it receives a subordination request from a member. Requests may be made by the member telephonically, or the Credit Union may be contacted by the new first mortgage lender who simply submits a subordination agreement to the Credit Union for signature.

THE SUBORDINATION PROCESS

The subordination process consists of the following steps:

-) The Credit Union is contacted by the member or the new first mortgage lender who requests the Credit Union's agreement to subordinate its second mortgage.
-) The Credit Union must review the subordination request to determine whether the new loan balance will exceed the old loan balance.
-) The Credit Union must review the Subordination Agreement and make any changes that are necessary.
-) The Credit Union should send a transmittal letter to the first mortgage lender along with the Subordination Agreement confirming that the Credit Union's agreement to subordinate is conditioned upon the proceeds of the new first mortgage loan being used to satisfy and discharge the existing first mortgage.

THE SUBORDINATION REQUEST

The Credit Union can develop its own Subordination Request Form and Checklist. Attached to this Operations Guide is a sample Subordination Request Form and a Checklist to be completed by the member.

If the Credit Union does not wish to use a Subordination Request Form and Checklist, the Credit Union can simply receive the Subordination Request from the new first mortgage lender. The request usually is in the form of a transmittal letter explaining the request and a Subordination Agreement for review by the Credit Union and if acceptable to the Credit Union for its signature. Many times, the first mortgage lender will also provide an updated appraisal to assist the Credit Union in determining the current value of the mortgaged premises and sometimes a title search is provided along with the appraisal.

REVIEW OF SUBORDINATION DOCUMENTATION

-) Subordination Agreement. The Credit Union should review the Subordination Agreement to make certain that the terms of the Agreement are acceptable to the Credit Union. Among the terms which should be reviewed by the Credit Union are the following:
- o Confirm the correct name and address of the Credit Union as the subordinating lender;
 - o Confirm the name and address of the new first mortgage lender;
 - o Confirm the dollar amount of the new first mortgage to which the Credit Union is subordinating; and
 - o Review the Agreement to make certain that there are no other provisions which are not acceptable to the Credit Union. For example, the Subordination Agreement may contain statements indicating that the Credit Union is waiving any claim against the new first mortgage lender as to the use of the mortgage proceeds. This is not acceptable since the mortgage proceeds from the new first mortgage loan must be used to satisfy the existing first mortgage loan.
 - o If you are uncomfortable reviewing the Subordination Agreement, please forward it to our office for review.
-) Title Search and Appraisal. These documents may or may not be submitted to the Credit Union with the Subordination Agreement. The title search is intended to confirm to the Credit Union the priority of the Credit Union's mortgage and to confirm the existing first mortgage lender. The appraisal is provided to provide the Credit Union with information concerning the approximate value of the mortgaged premises.

PROCEDURE TO COMPLETE THE SUBORDINATION OF THE CREDIT UNION'S MORTGAGE

Once the Subordination Agreement has been reviewed by the Credit Union or our office, and the Credit Union has confirmed that there is sufficient equity in the property to justify the Credit Union agreeing to subordinate its mortgage, the Credit Union can execute the Subordination Agreement and return it to the new first mortgage lender. Since the Subordination Agreement must be filed with the County Clerk's Office, it will be necessary for the Credit Union's signature to be notarized.

The Credit Union should return the Subordination Agreement with a transmittal letter that contains the following paragraph:

"The Credit Union has enclosed the Subordination Agreement requested by your lending institution. The Credit Union's agreement to subordinate its mortgage to your loan is specifically conditioned upon your agreement

that all or sufficient portion of the loan proceeds from your loan will be used by you to satisfy in full the existing mortgage on the property which has priority over the Credit Union's mortgage, as indicated in the Subordination Agreement and that you will arrange for the discharge of this mortgage so that the Credit Union will remain a second mortgage lender with only the mortgage referred to in the Subordination Agreement signed by the Credit Union having priority over the Credit Union's mortgage. If this is not the case, the Subordination Agreement signed by the Credit Union must be returned to the Credit Union immediately."

A copy of the Subordination Agreement and the applicable correspondence should be retained in the Credit Union's loan file for future reference.

SAMPLE SUBORDINATION AGREEMENT

A copy of the FNMA/FHLMC Subordination Agreement is attached for your review.

ADDITIONAL THOUGHTS

In general, the Credit Union would want to accommodate a member who is seeking to refinance their first mortgage since the member is usually more favorable loan terms which reduces the likelihood of the member becoming delinquent on the refinanced loan which reduces the likelihood of a default by the member.

Please feel free to contact our office if you have any questions concerning this Guide.

PETER J. LISKA, LLC