



Lender Relations After A Catastrophic Property Loss: Getting Your Mortgage Company To Release Insurance Proceeds

If you have a mortgage, and your home has suffered severe damage or been destroyed, some or all of the payment checks from your insurance company will be made payable jointly to BOTH you and your mortgage company. This happens because your lender has a financial interest in the property that your insurer will honor/protect.

Until your mortgage company releases its claim on some or all of the funds, they will sit in your mortgage company's account. This means that before you can begin to rebuild, you must first understand the process of how to get your mortgage lender to let go of your insurance proceeds.

The goal of this tip sheet is to give you strategies to get control of the insurance money as soon as possible. We will also provide information on how get your lender to release insurance proceeds when proceeds are greater than the amount you owe on your loan. You will also find out how to get paid interest on proceed funds while they are being held by your lender.

IMPORTANT NOTE: The information provided below assumes that the reader has standard California mortgage documents. You may not live in California—so read your specific documents carefully!

The standard California mortgage states:

“5. Property Insurance. Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss.”

“Improvements” are pretty much everything on the land that is not organic (dirt, grass, trees, bushes). “Improvements” include your house, gazebo, patio, fence, and driveway.

Q: Why can't I just deposit and use my insurance checks? Why does it have to go through my mortgage company first when I paid the insurance premiums?

A: When you borrowed money to buy your home, you agreed that one way the mortgage company would be protected would be that the mortgage company would be *co-insured*, right along with you, for any harm to your “improvements.”

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Your mortgage documents are set up to protect the mortgage company if you take your insurance rebuild money and disappear. In other words, your property and the house are the collateral for the loan; so if you cashed the insurance checks but did *not* rebuild, then the mortgage company would have a problem. The loan and insurance documents set up a system to prevent you from doing that.

Unless and until you get your mortgage company to agree to something different (in writing), every Coverage A check you get, and maybe some of your other coverage checks, will say something like: “Pay to the order of Jane Doe and Jane Doe’s Mortgage Company.”

You will be required to endorse/sign the check first, and your mortgage company will deposit the money into its own account, and then release the money to you later, once you have started the process of rebuilding your home.

Q: Will the mortgage company be a co-insured on *only* the Coverage A checks?

A: Perhaps. They may also be named on checks issued for “Other Structures”, “landscaping” etc. Paragraph 5 also says:

Property Insurance. If Borrower obtains any form of insurance coverage, not otherwise required by Lender, for damage to, or destruction of, the Property, such policy shall include a standard mortgage clause and shall name Lender as mortgagee and/or as an additional loss payee . . .

A good rule of thumb is to assume that the mortgage company could claim a right to be treated as a co-insured on insurance coverage for those things that *are* or *must stay* on the property when the house is sold -- plants, grass, the house, the fence, the driveway, etc.

But insurance companies often only co-write the Coverage A checks, and Loss Departments often do not challenge that.

Q: If the insurance checks total more than my mortgage, does the lender get to keep *more* money than the remaining amount I owe them on my mortgage?

A: The mortgage company should not be able to keep insurance proceeds in excess of the remaining amount of the loan secured by the mortgage. Also in paragraph 5 from the standard California mortgage, you only agree “... to generally assign rights to insurance proceeds to the holder of the Note up to the amount of the outstanding loan balance.” Indeed, for this reason, some mortgage companies also have a written policy saying the company only holds money up to the amount of the outstanding loan balance.

Q: Why does the company need such a policy if it already is part of the mortgage?

A: The mortgage company has a special department (the “Loss Department”) that handles control of rebuild money after you have had a catastrophic property loss. This work often is actually outsourced to an independent company. In either circumstance, the people you deal with may not know what the mortgage actually says.

Knowledge is power. Be tenacious. Read and understand your documents, and use that knowledge to your advantage. The Loss Department is generally not user friendly. Do not be surprised if:

1. The “Loss Department” will not, on its own, refund to you the extra money until you ask for it, or
2. It is difficult to talk to a live human being at the Loss Department at all, or
3. You get form responses to your letters, rather than a response that answers your questions.

Q: Will the mortgage company pay me interest on the insurance proceeds they are holding?

A: The answer is...probably, but not usually without a fight. That same paragraph 5 in the standard California mortgage also states: “Unless an agreement is made in writing or Applicable Law requires interest to be paid on such insurance proceeds, Lender shall not be required to pay Borrower any interest or earnings on such proceeds.”

Fortunately California **arguably** does have an “applicable law.” The California Civil Code states:

“§2954.8. Payment of Interest to Borrower.

(a) Every financial institution that makes loans upon the security of real property containing only a one-to-four-family residence and located in this state or purchases obligations secured by such property and that receives money in advance for payment of taxes and assessments on the property, for insurance, or for other purposes relating to the property, shall pay interest on the amount so held to the borrower. The interest on such amounts shall be at the rate of at least 2 percent simple interest per annum. Such interest shall be credited to the borrower's account annually or upon termination of such account, whichever is earlier.”

Many people successfully argue to their mortgage company that insurance proceeds checks to fund a rebuild are “money in advance for payment ... for ... purposes relating to the property,” within the meaning of Code Section 2954.8. Simply put, they get 2% interest.

CAUTION: We are unaware of anyone who has ever fought the issue all the way through to court, and so there is no “final” answer.

Q: What is another approach I could take to make sure I receive interest on the insurance payments?

A: There is another, different argument you could try. The leading book on California real estate law – *Miller & Starr California Real Estate*– argues that there is a California court decision suggesting that if a mortgage company holds the money in an interest bearing account, then the interest belongs to you. (This argument is in section 10:61 of the treatise titled [California Real Estate](#) by Miller & Starr.)

Catastrophic loss survivors have taken a variety of novel approaches to recover the interest on the insurance proceeds. One 2003 Cedar Fire Survivor asked his mortgage company for a copy of the deposit slip reflecting the account number the company deposited the funds into, and the account documents for that account verifying that funds held there neither bore interest nor were invested. Rather than complying with the demand, the mortgage company elected to pay the interest. This anecdote proves that sometimes being a pain in the neck matters more than whether the statute applies.

Q: How quickly can I get the lender to release the insurance checks?

A: Not as quickly as you would hope for. Once again, let us visit paragraph 5 of the standard California mortgage, which says,

“During such repair and restoration period, Lender shall have the right to hold such insurance proceeds . . . Lender may disburse proceeds for the repairs and restoration in a single payment or, in a series of progress payments as the work is completed.”

Q: But my contractor will not agree to rebuild my entire house before getting paid. What can I do?

A: You are right--it is a “business reality” that a builder is not going to do all the work before getting paid any of the money. It also is a “business reality,” however, that most builders are used to working in the environment where they are not paid entirely in advance, but rather get partial, periodic payments with at least some amount retained or withheld from payment until completion.

Your mortgage company understands this. Because your mortgage requires you to rebuild or restore your property to good condition after a fire, the mortgage company will not hold *all* the money to the end, because that could be a “breach [by the mortgage company] of the implied covenant of good faith and fair dealing.” This means the company has to play fair to avoid getting sued. So you will get the money in “progress payments.”

A typical progress payment policy is to release 1/3 of the held proceeds up front, 1/3 upon inspection verifying 50% completion, and 1/3 upon verifying 100% completion. There probably will be no “shortfall issue” until you are ¾ done with construction.

Q: Can the mortgage company just use the money to pay off the mortgage, even if I do not want them to?

A: The short answer is NO. That would also be a “bad faith” problem.

Q: So what is the bottom line?

A: Read your documents.

- Get in touch with your mortgage company, both by telephone and by mail.
- Stay in touch. Be persistent and patient, and be polite but firm.
- Keep a diary of the name and contact number (and the name of their superior and that person’s contact number) of EVERY PERSON you talk to.
- Write detailed letters that review what’s happened to date.

When dealing with your mortgage company, consider emphasizing that:

- Without the money, you cannot get their collateral rebuilt.
- Treating you well will be good public relations for them, and in this “sub-prime crisis” environment, they need good PR!
- You likely are not their only borrower who lost a home in your community. If there is a trial to determine if they are treating you fairly, then
 1. It will be on behalf of ALL of their borrowers who lost homes in the wildfire and
 2. Every juror will be either (a) someone who lost their home, (b) someone who knows someone who lost their home, or (c) someone who thinks “Oh my goodness I could lose my home!”
- Ask the mortgage company to document what happens to the money while they have it (does it generate interest, and if not, is it invested?) – the answer could be uncomfortable for them, and if so, that is good for you.

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