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BILL ANALYSIS

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House Bill 5832 (as passed by the Senate)
Sponsor: Representative Joseph Rivet
House Committee: Commerce
Senate Committee: Commerce and Labor

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RATIONALE

There evidently is some confusion as to whether Michigan law requires a mortgage document to include the terms of the loan. When a buyer purchases real property, he or she may enter into a mortgage agreement, with either the seller or a third party lender. Whether financing is obtained from the seller or from a mortgage lender, the "mortgage" is the document that allows the lender to place a lien on the property, while the "note" is a legal instrument evidencing the borrower's promise to repay the lender. Typically, the note includes the terms of the loan agreement, such as the principal amount owed, interest rate, installment payment amounts and schedule, and when final payment is due.

Two Federal court opinions from the 1990s seem to suggest that Michigan law requires the mortgage document to include financing and repayment terms for the mortgage to be valid. This evidently is not, and never has been, common practice in real estate law in Michigan, however. Thus, some people believe that the law should be amended to require that a mortgage simply describe the indebtedness it secures. Also, it has been suggested that some of the terminology describing the form of mortgages in statute should be updated.

CONTENT

The bill would amend Public Act 187 of 1881, which addresses the form of deeds and mortgages of real estate, to require that a mortgage of land "describe the indebtedness or obligations the mortgage secures" rather than "recite the sum for which the mortgage is granted, or the notes

or other evidence...of debt, or a description thereof, sought to be secured..." and the date of repayment.

A mortgage that meets the Act's wording requirements is a "good and sufficient" mortgage to the grantee and his or her "heirs, assigns, executors and administrators" with warranty from the grantor and his or her legal representatives. Under the bill, a mortgage meeting the wording requirements would be a "valid and enforceable" mortgage to the grantee and his or her "heirs, assigns, successors, and personal representatives" with warranty from the grantor and his or her legal representatives. Further, under the bill, such a mortgage would be of "marketable" rather than "perfect" title and would be "free from prior incumbrances" rather than "against all previous incumbrances".

In addition, the Act provides that, if the words "and warrant" are omitted, the mortgage is "good" but without warranty. Under the bill, instead, if the indebtedness or obligation secured were described generally, "such as 'all indebtedness that A.B. now and in the future owes to C.D.'", and the words "and warrant" were omitted from the form, the mortgage would be "valid and enforceable", but without warranty.

MCL 565.154

BACKGROUND

United States of America v Certain Real Property (800 F. Supp. 547)

In this 1992 case, the U.S. District Court for the Eastern District of Michigan granted summary judgment to claimants Charles and Marian Titus. The Federal government had sought the forfeiture of the residence of the Tituses' son, Stephen, in Whitmore Lake, Michigan. Stephen Titus had pleaded guilty to a charge of growing marihuana at the home. A year before Stephen was arrested for that activity, Charles and Marian Titus had executed a document specifying a loan amount, an interest rate, and a payment schedule for Stephen Titus to purchase the Whitmore Lake property from them.

Under Federal law, real property used to commit certain violations is subject to forfeiture, except to the extent of the interest of an owner who did not know of or consent to the violation. The Federal government cannot claim a greater interest in the property than what belonged to the wrongdoer. In forfeiture proceedings, the Federal courts recognize state laws governing property interests, and apply state laws to determine the interest of an innocent owner. In this case, therefore, the U.S. District Court examined Public Act 187 of 1881.

Claiming an ownership interest in the property and no knowledge of the violation, Charles and Marian Titus filed a motion for summary judgment against the Federal government's attempt to forfeit the property. The Federal government argued that the claimants were not owners of the property in question because the document executed by the claimants was not a valid mortgage under Michigan law.

Since the document executed by the Tituses did include the repayment terms of the money loaned, the sum of the mortgage, the date of repayment, and the interest rate, the Court held that it was a mortgage under Public Act 187 of 1881. Therefore, the Court granted the claimants' motion for summary judgment and ordered that the government's interest in the property was subject to the claimants' mortgage.

In Re.: Gary F. Boyd (185 B.R. 529)

In this 1995 case involving the bankruptcy of Gary F. Boyd, the United States Bankruptcy Court for the Eastern District of Michigan ruled that an agreement between Boyd and creditors did not constitute a

mortgage because the terms of repayment were not identified in the document.

In 1990, Boyd had signed a mortgage note payable in the amount of \$15,000. The note stated that the principal sum with interest would be paid at 8% annually until fully paid and that the note was secured by a first mortgage covering real estate in Antrim County. The entire transaction was included in the note and a separate mortgage was never obtained. Boyd paid the creditors \$200 per month for about two years.

After receiving no payments for some time, the creditors recorded the mortgage note with the Antrim County register of deeds in April 1994. In August 1994, Boyd filed for bankruptcy and claimed the Antrim County property exempt as the homestead. Several months later, Boyd was notified that the creditors had recorded the mortgage note with the register of deeds, creating a lien on the property. In March 1995, Boyd filed an adversarial proceeding to discharge the lien.

Boyd argued that the note did not qualify as a mortgage because, among other things, it did not state the terms of repayment and a separate mortgage was never obtained to secure the loan. He claimed that the document was intended merely as an unsecured promissory note. The creditors claimed that, even though the terms of repayment and the installment payment amounts were not specified in the note, it was presumed that the principal and interest were payable on demand. They also contended that recording the mortgage note perfected a lien on the property.

Citing the analysis of the U.S. District Court in *United States v Certain Real Property* (discussed above), the Bankruptcy Court held that, because the terms of repayment were not stated in the mortgage note and Public Act 187 of 1881 "requires that the terms of repayment be stated in a mortgage", the mortgage note in *Boyd* did not meet the statutory requirements of a mortgage. The Court ruled that the mortgage note was not a mortgage and the creditors had not perfected a security interest in the Antrim County property.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate

Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Mortgage documents executed and recorded in Michigan typically do not include the terms of repayment of the loan. Rather, information such as the loan principal, the interest rate, the installment amounts, and the schedule of repayment is included in the promissory note. The analysis of the U.S. District Court and the Bankruptcy Court in *Certain Real Property* and *Boyd*, however, suggests that a mortgage executed and recorded without identifying the terms of repayment is not valid or enforceable as to a creditor's claim of a lien on the property. Since a mortgage is simply a document to show the creditor's lien on the property purchased with the loan identified in the note, including the terms of the loan in the mortgage document is unnecessary. By requiring that a mortgage simply describe the indebtedness or obligation secured by the mortgage, the bill would codify what has been long-standing practice in real estate transactions.

Supporting Argument

If a mortgage had to include the terms of the loan to be an enforceable lien on real property, most Michigan creditors would be vulnerable to losing their security interest in real property. Although the *Boyd* case did not involve a third party lender, the decision could be used as a precedent for a delinquent debtor to exempt property purchased under a mortgage from a bank or other mortgage lender from a creditor's claims. A bank that did not include the terms of loan repayment in the mortgage document, then, could be left without an enforceable lien on the property bought with the mortgage loan.

Response: In order to protect lenders of mortgage loans currently in effect, the bill should apply retroactively.

Supporting Argument

By replacing archaic language in the statute, the bill would reflect more accurately the terminology used in modern real estate transactions. For example, a mortgage meeting the bill's requirements would be "valid and enforceable", rather than "good and sufficient" as under current law.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Maria Tyszkiewicz

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.