



COMMERCIAL REAL ESTATE INSIGHT & NEWS

The Bowditch & Dewey Real Estate Blog

A Lesson for Granting Loans and Encumbering Property

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Lender's beware. The case of [Financial Freedom Acquisition, LLC v. Dorothy LaRoche](#) (Hampden Superior Court, Civil Action No. 2011-00403) demonstrates why lenders need the advice of legal counsel when granting loans and encumbering property.

Financial Freedom Acquisition, LLC ("FFA") provided a reverse mortgage to LaRoche, despite the fact that LaRoche only held a life estate interest in the property being mortgaged. Although FFA was aware of the title status prior to granting the loan, it nonetheless failed to require the remainderman to execute the mortgage or to insist the property be deeded back to LaRoche prior to issuing the loan, paying off an existing mortgage and advancing LaRoche funds. Moreover, while the mortgage would have only encumbered the life estate interest, FFA also failed to record it.

FFA also failed to follow and adhere to HUD regulations governing the granting of reverse mortgages or to take the necessary steps to insure it received a priority interest in the premises securing its loan. This is especially important in the reserve loan situation as the Note is non-recourse against the principal. Accordingly, the only recourse the lender has is against the collateral.

The Court had no sympathy for FFA and declined to put FFA in a better position than the position in which it put itself. It found that the violation of HUD requirements for qualification of a reverse mortgage made the reverse mortgage invalid. Accordingly, the only security for the Note was under the security instrument that encumbered the life estate held by LaRoche. FFA tried a number of different tactics to persuade the Court to secure its loan including:

- Invalidating the deed creating the life estate and remainder interest because it lacked valid delivery and acceptance from the remainderman;
- Declare the remainder interest was taken subject to the reverse mortgage;
- Claims of unjust enrichment against the borrower and remainderman;
- Equitable subrogation; and

- Breach of contract and representations made by the borrower

All of which arguments failed.

In the end, FFA is left with a contractual obligation to pay LaRoche under the security instrument and Note for the remainder of her life. FFA's only security for this obligation is in a life estate. Both the payment obligations and security disappear when LaRoche dies. Moreover, the remainderman was found not be obligated to pay the debts of the life tenant. As a result, the Lender pays money to LaRoche during her lifetime and when she dies its only recourse is against her estate as an unsecured creditor. While this result may seem harsh, FFA could have avoided it through routine engagement of legal counsel who could have secured its priority interest and insure it with title insurance.