

Uniform Mortgage Modification Act

drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES



WITH PREFATORY NOTE AND COMMENTS

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Uniform Mortgage Modification Act

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Uniform Mortgage Modification Act

Prefatory Note

I. Purpose of the Act

The Uniform Mortgage Modification Act clarifies and simplifies the law governing mortgage modifications. It saves borrowers time and money by reducing legal uncertainties and transaction costs. Specifically, the act creates safe harbors for common modifications, while leaving others to existing law.

A mortgage is an agreement that creates an interest in real property to secure a debt or other obligation. Some states use agreements with different names such as deed of trust, trust deed, or indenture. Whatever its name, the agreement is called a mortgage in this act.

This prefatory note explains why this act is needed and how it works.

II. Why the Act Is Needed

A. Why Mortgages Are Modified

Mortgage modifications are not uncommon. There are many reasons that parties to a mortgage may wish to modify the mortgage or the obligations it secures. Residential or commercial borrowers may avoid a default or foreclosure with a modification that reduces payments, extends the loan, or capitalizes unpaid interest. The parties may convert a construction loan into permanent financing. Some credit facilities are updated periodically to reflect changing market conditions or to substitute portions of debt. Some borrowers may wish to increase the amount of their loans.

The parties often find that questions about the effect of a modification on the priority of the mortgage cause delay or prevent them from completing the modification. At best, this uncertainty about priority leads to increased transaction costs, which are ultimately passed on to the borrower. At worst, this uncertainty may discourage lenders from even considering a request to modify a mortgage loan.

B. Why Priority Is Important

The priority of a mortgage determines which mortgage loan gets paid first if the borrower stops paying and goes into bankruptcy or is foreclosed upon. Obviously, maintaining a first lien priority is better for lenders, but it also benefits borrowers because a lender is less likely to agree to a modification if the lender's priority is at risk.

C. Problems Existing Without a Statute

Without a statute, the law is not clear whether a modification of a mortgage loan affects the priority of the mortgage. Litigation over priority may be required even for common

modifications. *See, e.g.*, *Fraction v. Jacklily, LLC (In re Fraction)*, 622 B.R. 643, 648 (Bankr. E.D. Pa. 2020), *aff'd*, 2021 WL 4037508 (E.D. Pa. 2021) (involving modifications to extend maturity date of loan, reduce interest rate, and capitalize unpaid interest and escrow payments).

Generally, courts focus on whether a modification has a material adverse effect on junior lienholders, ruling that priority may be lost, in whole or in part, if junior lienholders are materially prejudiced by the modification. Results may differ among various courts. *Compare Fraction, supra*, at 650-652 (finding no loss of priority due to extension of maturity and other modifications) *with Citizens & Southern National Bank of South Carolina v. Smith*, 284 S.E.2d 770 (S.C. 1981) (holding that extension of maturity of mortgage caused loss of priority as against junior lienholder).

To avoid the risk of losing priority, a senior lienholder may request a junior lienholder's consent to a modification. But the junior lienholder may refuse consent even when it has no legitimate reason to refuse. Or the junior lienholder may demand a ransom payment for its consent.

In addition, without a statute, if a modification is found to constitute a novation of an obligation (i.e. found to be so substantial as to create a "new" obligation), the result of the modification may be that the mortgage no longer secures the original obligation, but only the "new" obligation. *See, e.g.*, *In re Fair Finance Co.*, 834 F.3d 651 (2016). The result is that the entire loan loses its priority.

Further, confusion exists as to whether a mortgage modification agreement must be recorded in order to maintain mortgage priority. *See, e.g.*, *Fraction v. Jacklily, LLC (In re Fraction)*, 622 B.R. 643, 651 n.11 (Bankr. E.D. Pa. 2020), *aff'd*, 2021 WL 4037508 (E.D. Pa. 2021). For residential borrowers, obtaining the acknowledgment required for recording a modification agreement presents a barrier to completing the loan modification.

Finally, even if a state has its own statute designed to address mortgage modifications and their priority, the locals depend to a greater or lesser extent on out-of-state lenders for financing. Out-of-state lenders, being unfamiliar with a local statute, may refuse to rely on it and proceed as if the state had no statute at all.

For these reasons, there is a need for a widely enacted uniform law to govern mortgage modifications.

III. How the Act Works to Fix These Problems

A. Safe Harbors

This act creates safe harbors for specific common mortgage modifications. For a modification within a safe harbor, Section 4(a) clearly establishes as a matter of law that:

1. The mortgage continues to secure the obligation as modified,
2. The modification does not affect the priority of the mortgage,

3. The mortgage retains its priority regardless of whether a modification agreement is recorded, and
4. The modification is not a novation.

The effect of Section 4(a) is to eliminate or lower the transaction costs of common modifications, saving time and money. These transaction costs on many loans may include, but are not limited to, recording fees, title insurance endorsements, and legal opinions. Section 4(a) will benefit borrowers and lenders, large and small, commercial and residential.

The following common modifications, called safe harbors, are listed in Section 4(b) of the act:

1. Extension of the maturity date of the obligation,
2. A decrease in the interest rate,
3. Certain changes in the method of calculating interest,
4. Capitalization of interest or other unpaid obligations,
5. Forgiveness, forbearance, or reduction of a secured debt or other obligation,
6. Modification of escrow or reserve account requirements,
7. Modification of insurance requirements,
8. Modification of an existing condition to an advance of funds,
9. Modification of a financial covenant, and
10. Modification of the payment amount or schedule resulting from another safe harbor modification.

Material prejudice or a similar standard is the common law basis for determining whether a modification causes a loss of priority. The safe harbor modifications in the act generally would not be considered materially prejudicial to a junior lienholder. So, Section 4(b) is generally consistent with the common law of material prejudice. And the act, like common law, protects the rights of junior lienholders.

The advantage of a uniform law on this subject is that a statute provides certainty, reduces the need for litigation, and reduces transaction costs. A uniform law is also useful for interstate transactions and multistate transactions. A lender in one state will not have to become familiar with the mortgage modification laws of other states and can rely with confidence on the same uniform law in another state. A borrower operating in several states will need to become familiar with only one mortgage modification law.

B. Modifications Outside the Safe Harbors

Modifications that fall outside the safe harbors or are excluded from the act are governed by other law. These modifications may or may not prejudice a junior lienholder and so, under other law, may or may not cause a loss of priority.

An example of a modification that falls outside of the safe harbor is a new advance of funds not contemplated by the original loan. This increase in the principal of the loan is not in the safe harbor because it would materially prejudice a junior lienholder. Cases hold that the

senior lienholder loses priority to the extent of the increase. *See, e.g., Burney v. McLaughlin*, 63 S.W.3d 223, 233-34 (Mo. Ct. App. 2001); *Lennar Partners*, 57 Cal.Rptr.2d 435, 440-42 (Cal. Ct. App. 1996). Another example is an increase in the interest rate of a loan because such an increase can materially prejudice a junior lienholder. *See Burney, supra*, at 233; *Shultis v. Woodstock Land Dev. Assocs.* 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993).

Other modifications that fall outside of the safe harbor list may not prejudice a junior lienholder and thus under other law would not cause a loss of priority.

C. Exclusions from Operation and Effect of Act

Some modifications are excluded by Section 3(c) from the operation of this act. These modifications are governed by other law:

1. A release of, or addition to, the collateral,
2. Changes in the borrower or guarantor, and
3. Transfers of a loan.

Changes to the collateral or changes to the borrower or a guarantor are excluded because they may prejudice a junior lienholder depending upon the circumstances. Loan transfers are excluded because they are governed by the Uniform Commercial Code.

Section 3(b) makes it clear that the act does not affect certain existing law. The act does not affect:

1. Law governing the required content of a mortgage,
2. A statute of limitations or other law governing the expiration or termination of the right to enforce an obligation,
3. A recording statute,
4. A statute governing the priority of a tax or other governmental lien,
5. A statute of frauds or the Uniform Electronic Transactions Act or similar statute, or
6. Law governing the priority of a future advance, except as provided in the act.

For modifications within the safe harbor, recording a mortgage modification is not required to maintain the priority of the mortgage. However, recording may be necessary or desirable for other reasons. For example, when the maturity of an obligation is extended, some states have statutes that make recordation necessary in order to extend the right to enforce the obligation. The act does not affect these statutes.

IV. Summary

The act is a game-changer that will benefit borrowers and lenders, large and small, commercial and residential. It makes the law more certain and protects the priority of a mortgage for modifications within the safe harbors. It adopts an appropriate balance between the right of the parties to a senior mortgage to modify loans and the right of junior lienholders to avoid material prejudice to their lien position. With greater clarity, borrowers and lenders should be able to avoid undesirable transaction costs and the threat of litigation over priority issues for common modifications. The act will also facilitate loan modifications to avoid foreclosure.

Uniform Mortgage Modification Act

Section 1. Title

This [act] may be cited as the Uniform Mortgage Modification Act.

Section 2. Definitions

In this [act]:

(1) “Electronic” means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

(2) “Financial covenant” means an undertaking to demonstrate an obligor’s creditworthiness or the adequacy of security provided by an obligor.

(3) “Modification” includes change, amendment, revision, correction, addition, supplementation, elimination, waiver, and restatement.

(4) “Mortgage”:

(A) means an agreement that creates a consensual interest in real property to secure payment or performance of an obligation, regardless of:

(i) how the agreement is denominated, including a mortgage, deed of trust, trust deed, security deed, indenture, and deed to secure debt; and

(ii) whether the agreement also creates a security interest in personal property; and

(B) does not include an agreement that creates a consensual interest to secure a liability owed by a unit owner to a condominium association, owners’ association, or cooperative housing association for association dues, fees, or assessments.

(5) “Mortgage modification” means modification of:

(A) a mortgage;

(B) an agreement that creates an obligation, including a promissory note, loan agreement, or credit agreement; or

(C) an agreement that creates other security or credit enhancement for an obligation, including an assignment of leases or rents or a guaranty.

(6) “Obligation” means a debt, duty, or other liability, secured by a mortgage.

(7) “Obligor” means a person that:

(A) owes payment or performance of an obligation;

(B) signs a mortgage; or

(C) is otherwise accountable, or whose property serves as collateral, for payment or performance of an obligation.

(8) “Person” means an individual, estate, business or nonprofit entity, government or governmental subdivision, agency, or instrumentality, or other legal entity.

(9) “Recognized index” means an index to which changes in the interest rate may be linked that is:

(A) readily available to, and verifiable by, the obligor; and

(B) beyond the control of the person to whom the obligation is owed.

(10) “Record”, used as a noun, means information:

(A) inscribed on a tangible medium; or

(B) stored in an electronic or other medium and retrievable in perceivable form.

(11) “Sign” means, with present intent to authenticate or adopt a record:

(A) execute or adopt a tangible symbol; or

(B) attach to or logically associate with the record an electronic symbol,

sound, or process.

Comment

1. **Electronic.** The definition of “electronic” is the standard Uniform Law Commission definition.

2. **Financial Covenant.** Examples of financial covenants include requirements for a borrower, guarantor, or other obligor to maintain a certain level of income or net worth, for maintenance of a certain loan-to-value ratio or debt-service ratio, for furnishing financial records, for production of tax returns, and for maintenance of deposit accounts with the lender.

3. **Modification.** The term “modification” is broad and encompasses a change, amendment, revision, correction, addition, supplementation, elimination, waiver, or restatement. A modification may be made by any enforceable means of agreement or communication, although a waiver may sometimes occur by act or omission.

4. **Mortgage.** A “mortgage” is any agreement that creates a consensual interest in real property to secure payment or performance of an obligation. Depending upon local usage and custom, an agreement that creates a consensual interest in real property to secure payment or performance of an obligation may be denominated a mortgage, deed of trust, trust deed, security deed, indenture, deed to secure debt, or the like. An installment land contract, sometimes called a contract for deed, is included within the definition of a mortgage if under state law it creates a consensual interest in real property to secure payment or performance of an obligation. A mortgage may also create a security interest in fixtures and personal property in addition to the real property that it encumbers, and in such a case, it is still a mortgage. A security interest in personal property created in a mortgage is, of course, governed by the Uniform Commercial Code, including its rules for perfection and priority.

The definition of mortgage excludes an agreement that creates a consensual interest to secure an obligation owed by a unit owner to a condominium association, owners’ association, or cooperative housing association for association dues, fees, or assessments because the act is not intended to apply to the modification of a declaration of covenants, conditions, and restrictions or other agreement that creates an obligation owed by a unit owner to the association for association dues, fees, or assessments. A unit owner includes a homeowner, condominium owner, or cooperative unit owner or lessee who is a member of the association (or a shareholder in the case of a cooperative). The reason for the exclusion is that the modification of such an agreement does not raise the same types of issues raised by modifications of other consensual liens.

The definition of mortgage is based on definitions in recent real property acts such as the Uniform Home Foreclosure Procedures Act, the Model Negotiated Alternative to Foreclosure Act, and the Uniform Nonjudicial Foreclosure Act; however, the definition is tailored specifically for this act. Real property acts have not used a consistent definition for the term mortgage because the various acts need different definitions.

5. **Mortgage modification.** A “mortgage modification” is a modification of the terms of

the mortgage itself, of an agreement that creates an obligation secured by the mortgage, or of an agreement that creates other security or credit enhancement. The term includes the modification of a promissory note, loan agreement, credit agreement, guaranty, assignment of leases or rents, and the like.

A change that occurs upon condition under the existing terms of a mortgage or other record is not a mortgage modification because it is not a modification of the agreement. Such a change is dictated by the terms of the agreement and does not change the agreement. For example, a promissory note may provide for an increase in the interest rate upon a default by the borrower (a so-called “default interest rate”). Similarly, the promissory note may provide for an adjustment of the interest rate at specified time intervals or when changes occur in an index rate. As another example, a mortgage may provide for the creation of an escrow account upon the occurrence of certain conditions. These changes are not mortgage modifications but are existing terms of the agreement between the parties.

6. Obligation. An obligation as defined in the act is one that is secured by a mortgage. The term includes a non-recourse debt, whether the debt is non-recourse due to the application of anti-deficiency judgment legislation, agreement of the parties, or for other reasons.

7. Obligor. This definition is based on the definition of the term in the Uniform Home Foreclosure Procedures Act. Subsection (a) covers the borrower or debtor; subsection (b) covers a mortgagor who is not the borrower or debtor; and subsection (c) covers a guarantor, including a guarantor whose obligation arises upon a condition, and a party who has encumbered other property to secure an obligation.

8. Person. The definition of “person” is the standard Uniform Law Commission definition.

9. Recognized index. This definition is based on Office of the Comptroller of the Currency regulations of the index for an adjustable-rate mortgage loan at 12 C.F.R. § 34.22.

10. Record. The definition of “record”, used as a noun, is the standard Uniform Law Commission definition.

11. Sign. The definition of “sign” is the standard Uniform Law Commission definition.

Section 3. Scope

(a) Except as provided in subsection (c), this [act] applies to a mortgage modification.

(b) This [act] does not affect:

(1) law governing the required content of a mortgage;

(2) a statute of limitations or other law governing the expiration or termination of

a right to enforce an obligation or a mortgage;

(3) a recording statute;

(4) a statute governing the priority of a tax lien or other governmental lien;

(5) a statute of frauds or [cite to state's Uniform Electronic Transactions Act or similar statute]; or

(6) except as provided in Section 4(b)(8), law governing the priority of a future advance.

(c) This [act] does not apply to any of the following modifications:

(1) a release of, or addition to, property encumbered by a mortgage;

(2) a release of, addition of, or other change in an obligor; or

(3) an assignment or other transfer of a mortgage or an obligation.

Comment

1. **Scope.** Except as provided in subsections (b) or (c), the act applies to a mortgage modification, defined as the modification of the terms of a mortgage, of an agreement that creates an obligation secured by the mortgage, or of an agreement that creates other security or credit enhancement. An agreement that creates an obligation secured by a mortgage may include a promissory note, loan agreement, or a credit agreement. An agreement that creates security or other credit enhancement may include an assignment of leases or rents, a guaranty, security agreement, pledge agreement, or deposit account control agreement.

2. **Exclusions.** The act does not change or override certain laws, and subsection (b) lists those laws. Subsection (c) lists modifications to which the act does not apply. Exclusions and other provisions herein that refer to “law” or “laws” refer to statutes, regulations, and the common law.

3. **Laws governing contents of a mortgage.** The act does not affect any law that requires a mortgage to include certain terms, such as a law that requires that a mortgage state the maximum principal of a loan. If the parties modify one of the required terms, a modification agreement may need to be recorded to satisfy the requirements of the law.

4. **Statutes of limitations.** The act does not override statutes of limitations, statutes of repose, marketable title acts, or other laws that govern the expiration or termination of the right to enforce an obligation or a mortgage and that may depend upon the maturity date of a loan as stated in a recorded mortgage. For example, some states have statutes that make recordation a

necessity in order to extend the right to enforce an obligation or a mortgage based on the maturity date of the obligation as stated in the recorded mortgage or extension agreement. *See, e.g.,* Ariz. Stat. 33-714(A); Tex. Civ. Prac. & Rem. Code § 16.036.

5. Recording statutes. The act does not affect recording statutes. Recording statutes vary but are generally classified as race, notice, or race-notice acts. Recording statutes determine the priority of a subsequent purchaser's interest and may reverse the common law priority rule of first-in-time, first-in-right. Recording statutes generally do not require recording of a record that creates an interest in real property but rather make recording necessary in order to protect against loss of priority. Thus, a mortgagee will want to record a mortgage to preserve its priority. A modification agreement generally does not create a new interest in real property but modifies a mortgage or obligation. Thus, a mortgage modification agreement does not need to be recorded except if necessary to extend the statute of limitations as discussed in Comment 4 above, when the modification changes a required mortgage term as discussed in Comment 3 above, or if otherwise required by a statute such as the Ohio statute referenced below. Section 4(a)(3) provides that, for safe harbor modifications, failure to record a modification agreement will not cause a loss of priority.

In Ohio a mortgage modification does not take effect until it is delivered to the recorder. Ohio Rev. Code Ann. § 5301.231. Ohio legislators should consider whether to amend that statute or to add it as an exclusion from the scope of the act in this section and omit section 4(a)(3).

6. Statutes governing priority of governmental liens. The act does not affect any statute that dictates the priority of a tax lien or other governmental lien.

7. Statutes of frauds and Uniform Electronic Transactions Act. The act does not affect the statute of frauds or the state's Uniform Electronic Transactions Act or similar statute governing electronic transactions.

8. Laws governing the priority of a future advance. The act does not override existing law governing future advances except that a modification of an existing condition to an advance of funds is within the safe harbor as provided in Section 4(b)(8). Most states have legislation addressing the priority of future advances and abrogating completely or partly the distinction between obligatory and optional advances. *See, e.g.,* Mich. Comp. Laws § 565.902; Wash. Rev. Code § 61.12.190. Some states retain the common law distinction between optional and obligatory advances. The act does not affect existing law in this area except to the extent that a modification (including waiver) of an existing condition to an advance of funds does not cause a loss of priority for the advance under Section 4(b)(8).

9. Release of or addition to collateral. The act does not apply to a modification of a mortgage that releases or adds to the mortgaged property. Other modifications completed in the same transaction as a release or addition of mortgaged property may be covered by the act and fall within the safe harbors. Other law governs the effect of a modification that releases or adds to the mortgaged property.

10. Release, addition, or change in obligor. The act does not apply to a release of,

addition of, or other change in the identity of a borrower, mortgagor, guarantor, or other obligor. Other modifications completed in the same transaction as a release, addition, or change in an obligor may be covered by the act and fall within the safe harbors. Other law governs a modification that changes the identity of the borrower, mortgagor, guarantor, or other obligor.

11. Assignment of a mortgage or an obligation. The act does not apply to the assignment or other transfer of a mortgage loan or other obligation secured by a mortgage. This section makes clear that these transfers are not covered by the act. Other modifications completed at the same time as an assignment of a mortgage or obligation may be covered by the act and fall within the safe harbors. Other law governs assignment or other transfer of a mortgage loan or other obligation secured by a mortgage.

Section 4. Effect of Mortgage Modification

(a) For a mortgage modification described in subsection (b):

- (1) the mortgage continues to secure the obligation as modified;
- (2) the priority of the mortgage is not affected by the modification;
- (3) the mortgage retains its priority regardless of whether a record of the mortgage

modification is recorded in the [public land records]; and

- (4) the modification is not a novation.

(b) Subsection (a) applies to one or more of the following mortgage modifications:

- (1) an extension of the maturity date of an obligation;
- (2) a decrease in the interest rate of an obligation;
- (3) if the change does not result in an increase in the interest rate of an obligation

as calculated on the date the modification becomes effective:

(A) a change to a different index that is a recognized index if the previous index to which changes in the interest rate were linked is no longer available;

(B) a change in the differential between the index and the interest rate;

(C) a change from a floating or adjustable rate to a fixed rate; or

(D) a change from a fixed rate to a floating or adjustable rate based on a recognized index;

- (4) a capitalization of unpaid interest or other unpaid monetary obligation;
- (5) a forgiveness, forbearance, or other reduction of principal, accrued interest, or other monetary obligation;
- (6) a modification of a requirement for maintaining an escrow or reserve account for payment of an obligation, including taxes and insurance premiums;
- (7) a modification of a requirement for acquiring or maintaining insurance;
- (8) a modification of an existing condition to advance funds;
- (9) a modification of a financial covenant; and
- (10) a modification of the payment amount or schedule resulting from another modification described in this subsection.

(c) The effect of a mortgage modification not described in subsection (b) is governed by other law.

Comment

1. **Applicability.** Section 4 applies to a modification of the terms of a mortgage, of an agreement that creates an obligation, or of an agreement that creates other security or credit enhancement, including modification of a promissory note, loan agreement, credit agreement, assignment of leases or rents, or guaranty. The provisions of subsection (a) apply to modifications that are within the list in subsection (b) of safe harbor modifications. Other law governs modifications that are not within the list.

2. **Security.** Most mortgages state explicitly that the mortgage continues to secure obligations as modified. For modifications within the safe harbor, the mortgage continues to secure obligations as modified even without such a provision, and modifications within the safe harbor are not a novation.

3. **Priority.** The act creates a safe harbor for modifications that will not cause the loss of priority of a mortgage. Under common law and the Restatement, if an obligation secured by a mortgage is modified, the mortgage “retains priority as against junior interests in the real estate, except to the extent that the modification is materially prejudicial to the holders of such interests” Restatement (Third) of Property—Mortgages § 7.3(b). The act creates certainty by providing that certain modifications of obligations do not cause a loss of priority.

Commercial loans typically prohibit secondary financing without the first lender’s

consent and contain a due-on-encumbrance clause. If the holder of a senior mortgage agrees to a junior mortgage, the parties will generally enter into an intercreditor agreement defining their respective rights and obligations with respect to the collateral and the loans, and the act does not affect an intercreditor agreement that dictates priority as between the parties thereto. However, priority issues that arise with respect to judgment liens and mechanics' liens or in the absence of an intercreditor agreement are governed by the act for modifications within the safe harbor.

For residential lenders, the Garn-St. Germain Act, 12 U.S.C. 1701j-3, prohibits the exercise of a due-on-encumbrance clause in a residential mortgage. Thus, residential borrowers may and often do obtain secondary financing such as a home equity loan. The act prevents loss of priority for modifications of a residential mortgage that fall within the safe harbor.

4. Recording. For modifications within the safe harbor, recording a record of a mortgage modification is not required to maintain the priority of the mortgage. Although recording of a modification agreement is not necessary to maintain the priority of the mortgage, recording may be necessary or desirable for other reasons. The act does not affect a state's recording statute or any law governing the required content of a mortgage. Section 3(b)(1), (3). For example, a lender may choose to record a modification agreement to give notice to third parties. If the maturity date of a loan is extended, a lender may want to record a modification agreement to give public notice of the extension of the statute of limitations for enforcement of the mortgage. Some states have statutes that make recordation a necessity in order to extend the right to enforce an obligation or a mortgage based on the maturity date of the obligation as stated in the recorded mortgage or extension agreement. *See, e.g.,* Ariz. Stat. 33-714(A); Tex. Civ. Prac. & Rem. Code § 16.036.

In Ohio a mortgage modification does not take effect until it is delivered to the recorder. Ohio Rev. Code Ann. § 5301.231. Ohio legislators should consider whether to amend that statute or to add it as an exclusion from the scope of the act and omit 4(a)(3).

5. No novation. A novation, in the context of a mortgage loan, means a replacement of the existing obligation with a new obligation. Courts may find that a modification of a loan is so substantial that it is treated as a new loan. If a modification is so substantial as to constitute a novation of the loan, some cases have held that the mortgage no longer secures the modified loan. *See, e.g.,* In re Fair Finance Co., 834 F.3d 651 (2016). Subsection (a)(4) specifies that modifications that fall within the safe harbor do not constitute a novation. Thus, if a modification is within the safe harbor, the modified loan does not replace the original loan with a new loan, and the mortgage continues to secure the obligation.

6. Safe harbor modifications. Subsection (b) lists modifications that fall within the safe harbor. The listed modifications are common modifications that generally would not be materially prejudicial to a junior interest holder under common law. Some of the listed modifications, such as decreasing the interest rate or forgiving unpaid interest, would always be of benefit to a junior interest holder. Other modifications in the list would usually be beneficial to a junior interest holder or would not be materially prejudicial. So, to a great extent, Subsection (b) is consistent with existing law with respect to priority. These safe harbor modifications are:

a. **Extension of maturity date.** Most courts hold that a junior lienholder is not materially prejudiced by the extension of the maturity date of a loan. *See, e.g.,* Lennar Northeast Partners v. Buice, 57 Cal. Rptr. 2d 435, 440 (Cal. Ct. App. 1996); Shultis v. Woodstock Land Dev. Assocs., 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993); Guleserian v. Fields, 218 N.E.2d 397, 401-02 (Mass. 1966) (“The holder of the junior encumbrance is regarded as necessarily taking the risk of a postponement (frequently an advantage to a second mortgagee) of the date of payment of the whole or part of the senior mortgage debt.”). The Restatement position is that an extension of the maturity of a senior mortgage loan is generally beneficial to junior lienholders because it makes foreclosure of the senior lien less likely. *See* Restatement (Third) of Property—Mortgages § 7.3 cmt. c & illus. 7, 8. Occasionally, courts hold otherwise, *see, e.g.,* Citizens & Southern National Bank of South Carolina v. Smith, 284 S.E.2d 770 (S.C. 1981), thus illustrating the importance of uniform legislation in the area. An extension of the maturity of a loan is a very common modification, and clarity that it does not cause a loss of priority will save time and expense, facilitate loan modification to avoid foreclosure, and avoid litigation.

b. **Decrease in interest rate.** A decrease in the interest rate does not prejudice a junior interest holder. Instead, a decrease in the interest rate benefits the junior interest holder by decreasing the amount of the obligation and by making it more likely that the borrower can pay.

c. **Modification of method of calculating interest.** When an interest rate index becomes unavailable, the parties must designate a different index for calculating interest, together with a change in the spread between the interest rate and the index. In addition, parties may change from a fixed to a floating or adjustable rate or vice versa. Such a modification may result in an increase or decrease in the amount of interest owed, and the parties may not know at the time of the modification whether it will ultimately result in an increase or decrease in the total amount of interest to be paid. Subsection (b)(3) creates a safe harbor for those changes that do not result in an increase in the interest rate as calculated at the time of the modification. Whether a change is within the safe harbor is determined based on the interest rate index on the date of the modification.

d. **Capitalization of unpaid interest or another unpaid obligation.** Capitalization of unpaid interest increases the principal of a loan; however, unpaid obligations are already owed and secured by a mortgage. Thus, it does not prejudice a junior lienholder in the same way that a new advance would. *See* Fraction v. Jacklily, LLC (*In re* Fraction), 622 B.R. 642 (Bankr. E.D. Pa. 2020), *aff’d*, 2021 WL 4037508 (E.D. Pa. 2021). Capitalization of unpaid interest is a modification that commonly occurs when a borrower is in default and the lender has agreed to the modification as an alternative to foreclosure. Avoiding foreclosure by a senior mortgage holder benefits a junior lienholder. In addition, when unpaid amounts are capitalized, the loan is no longer in default; thus, default interest and late charges will stop accruing, which also benefits a junior lienholder.

e. **Forgiveness, forbearance, or reduction of obligation.** Forgiving or otherwise reducing a monetary obligation benefits a junior interest holder.

f. **Insurance and escrow requirements.** Changes in the requirements for maintaining insurance and changes in requirements for maintaining an escrow or reserve account

should not prejudice a junior lienholder and may be a benefit if the modification better protects the collateral and insures the payment of insurance premiums, taxes, or other obligations.

g. Modification of an existing condition to advance funds. If a loan already provides for an advance, the waiver or modification of a condition to that advance should not materially prejudice a junior lienholder in most circumstances. In a construction loan, the advance of funds allows the borrower to continue construction and to pay contractors and subcontractors, which should be of benefit to a junior lienholder.

h. Modification of a financial covenant. A financial covenant is an undertaking to demonstrate the creditworthiness of a borrower, guarantor, or other obligor or the adequacy of security provided by the borrower, guarantor, or other obligor. Financial covenants are commonly modified in commercial loans and should not generally cause material prejudice to a junior lienholder. Examples of financial covenants include requirements for a borrower to maintain a certain level of income or net worth, for maintenance of a certain loan-to-value ratio or debt service ratio, for furnishing financial records, for production of tax returns, and for maintenance of deposit accounts with the lender.

i. Modification of payment amount or schedule. Some of the safe harbor modifications may result in changes in the payment amount or schedule. For example, a decrease in the interest rate may result in lower payments, and an extension of the maturity date of a loan will result in a changed payment schedule. These modifications are also within the safe harbor.

7. Modifications not within the safe harbor. Modifications that are not within the safe harbor are governed by other law. Under common law, a mortgage as modified retains its priority except to the extent that a modification materially prejudices junior interest holders. *See* *Fraction v. Jacklily, LLC (In re Fraction)*, 622 B.R. 642, 649 (Bankr. E.D. Pa. 2020), *aff'd*, 2021 WL 4037508 (E.D. Pa. 2021). Under the Restatement, a “mortgage as modified retains priority as against junior interests in the real estate, except to the extent that the modification is materially prejudicial to the holders of such interests” Restatement (Third) of Property—Mortgages § 7.3(b). The safe harbor modifications in this act are those that generally would not prejudice a junior interest holder. Other modifications may or may not materially prejudice a junior interest holder and thus may or may not cause a loss of priority. Note that a modification may result in a split priority with the senior mortgage losing priority only to the extent that the modification prejudices the junior interest holder. *See, e.g., Burney v. McLaughlin*, 63 S.W.3d 223, 233-34 (Mo. Ct. App. 2001); *Shultis v. Woodstock Land Dev. Assocs.*, 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993).

8. Examples. The following examples illustrate the operation of this section.

a. Example 1: A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage. The interest rate on the loan is 7% per annum. A creditor obtains a judgment lien against the mortgaged property. The borrower and lender subsequently agree to extend the term of the loan for an additional five years, to reduce the interest rate to 6% per annum, and to require flood insurance. The modifications result in a change in the borrower’s payments. Because the modifications are all within the safe harbor list,

the lender retains its priority as against the judgment lien creditor. Recordation of a modification agreement is not necessary to retain priority, but the lender may choose to require recordation in order to give notice to third parties of the new maturity date.

b. **Example 2:** A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage. The loan does not provide for additional advances. A creditor obtains a judgment lien against the mortgaged property. The borrower and lender subsequently agree to modify the loan to increase the principal amount of the loan to \$150,000, and the lender advances the additional \$50,000. Because this modification is not within the safe harbor list and materially prejudices a junior interest holder, the lender may lose priority to the extent that the judgment lien creditor is prejudiced. Most courts would hold that the priority is split, with the lender retaining priority as to the original loan terms and losing priority only as to the new advance. *See, e.g., Shultis v. Woodstock Land Dev. Assocs.*, 594 N.Y.S.2d 890, 893 (N.Y. App. Div. 1993) (split priority for increase in interest rate).

c. **Example 3:** A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage on the borrower's home. The borrower subsequently obtains a home equity loan in the amount of \$20,000. The borrower later goes into default on the first mortgage loan and negotiates with the loan servicer to modify the loan. Modifications include an extension of the maturity date of the loan by three years, a reduction in the interest rate on the loan for two years, the capitalization of unpaid interest, and the addition of an escrow requirement for taxes and insurance. The first lien lender retains its priority as against the home equity loan because the modifications are all within the safe harbor. Recordation of a modification agreement is not necessary to retain priority.

d. **Example 4:** A lender makes a construction loan in the principal amount of \$100,000 secured by a mortgage. The loan agreement lists conditions which must be satisfied before each advance of funds. The lender agrees to waive one of the conditions to an advance so that construction may continue. The lender retains its priority as against any mechanic's liens because the waiver of the condition is within the safe harbor list. Recordation of a modification agreement is not necessary to retain priority.

e. **Example 5:** A lender makes a construction loan in the principal amount of \$100,000 secured by a mortgage with a floating interest rate based on an index. Because of a dispute with a subcontractor, the subcontractor has filed a mechanic's lien, which is subordinate to the lender's construction loan. After construction is complete, the parties negotiate to extend the maturity of the loan by five years, to fix the interest rate at a rate that is 1% lower than the floating rate on the date of the closing of the modification, and to add financial covenants. The promissory note is restated with only the listed modifications. The lender retains its priority as against the mechanic's liens because the modifications are all within the safe harbor list. Recordation of a modification agreement is not necessary to retain priority. If the lender elects to record the modification agreement to reflect the change in the loan from a construction loan to a permanent loan, the recordation does not affect the lender's retention of its priority.

f. **Example 6:** A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage. The interest rate on the loan is fixed at 7%

per annum. A creditor obtains a judgment lien against the mortgaged property. The borrower and lender subsequently agree to change the interest rate to 1% above SOFR. On the date that the modification becomes effective, the interest rate calculated as 1% above SOFR is less than 7%. Because the modification of the interest rate is within the safe harbor list, the lender retains its priority as against the judgment lien creditor.

g. Example 7: A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage. A creditor subsequently obtains a judgment lien against the mortgaged property. The borrower is in financial distress, and the borrower and lender negotiate numerous modifications to the loan. Some of the modifications are within the safe harbor list and others are not. If a court determines that the modifications not within the safe harbor are not materially prejudicial to the judgment lien creditor, the lender retains its priority under common law.

h. Example 8: A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage. A creditor subsequently obtains a judgment lien against the mortgaged property. The loan is assigned to a new lender, and in connection with the assignment, the interest rate of the loan is reduced and the maturity of the loan is extended. Because the interest rate reduction and extension of maturity are within the safe harbor, the lender retains its priority under the act. Because an assignment of a mortgage loan does not affect its priority, the lender retains its priority under common law.

i. Example 9: A lender makes a loan evidenced by a promissory note in the principal amount of \$100,000 secured by a mortgage on the borrower's home. The borrower subsequently obtains a home equity loan in the amount of \$20,000. The borrower later goes into default on the first mortgage loan and negotiates with the loan servicer to modify the loan. The lender splits the loan into two parts with one part bearing an increased interest rate and the other part bearing no interest. These changes result in lower payments, and the total amount of interest that the borrower is paying on both parts of the loan is less than the amount of interest before the modification. This modification is a reduction in the interest rate on the loan, and the lender retains its priority under the act.

Section 5. Uniformity of Application and Construction

In applying and construing this uniform act, a court shall consider the promotion of uniformity of the law among jurisdictions that enact it.

Section 6. Relation to Electronic Signatures in Global and National Commerce Act

This [act] modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq.[, as amended], but does not modify, limit, or supersede 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices

described in 15 U.S.C. Section 7003(b).

Legislative Note: *It is the intent of this act to incorporate future amendments to the cited federal law. A state in which the constitution or other law does not permit incorporation of future amendments when a federal statute is incorporated into state law should omit the phrase “, as amended”. A state in which, in the absence of a legislative declaration, future amendments are incorporated into state law also should omit the phrase.*

Comment

The federal Electronic Signatures in Global and National Commerce Act, popularly known as “E-Sign”, was adopted in 2000 to facilitate the use of electronic records and signatures in commercial transactions. Subject to exceptions not relevant here, E-Sign mandates the acceptance of electronic contracts and electronic signatures in interstate or foreign commerce. It largely tracks the Uniform Electronic Transactions Act, adopted by the ULC in 1999, but includes consumer consent provisions and prohibits state law from giving greater legal effect to any specific technology or technical specification. Under Section 102 of E-Sign, state legislation attempting to regulate electronic records and signatures can opt out of federal preemption, allowing some modification to the federal law, so long as the State treats the records or signatures consistent with E-Sign. In order to take advantage of the exception to preemption, the state law must take specific reference to E-Sign as provided in Section 6. See 15 U.S.C. Section 7002(a)(2)(B).

Section 7. Transitional Provision

This [act] applies to a mortgage modification made on or after [the effective date of this [act]] regardless of when the mortgage or the obligation was created.

Comment

1. **Prospective application.** The act applies prospectively to mortgage modifications that occur on or after the effective date of the act. It does not apply retroactively to modifications that occurred before the effective date of the act. The act can apply to a modification made to the terms of a mortgage created before the effective date of the act or to an agreement that creates, secures, or provides credit enhancement for an obligation that was created before the effective date of the act as long as the modification occurs after the effective date of the act.

2. **Example:** At the time that the act becomes effective, A has a first mortgage, and B has a second mortgage on a borrower’s property. After the effective date of the act, A and the borrower modify the first mortgage loan to extend its maturity. The act applies, and A does not lose priority.

[Section 8. Severability

If a provision of this [act] or its application to a person or circumstance is held invalid,

the invalidity does not affect another provision or application that can be given effect without the invalid provision.]

Legislative Note: *Include this section only if the state lacks a general severability statute or a decision by the highest court of the state stating a general rule of severability.*

Section 9. Effective Date

This [act] takes effect . . .