Loan recording mess costing Va.

'WE'RE TRUSTING'

Homeowners who don't qualify getting tax break

BY DAVID S. HILZENRATH

Countless homeowners in Virginia are getting a tax break for which they don't really qualify because a mortgage documentation mess makes it hard to determine who qualifies, officials say.

The loss of tax revenue for local governments and the state is another result of the lending industry growing so fast and becoming so complex during its go-go years that it outstripped its paper trail.

Because the problem involves blind spots in official records, no one can say how much revenue is being lost. But the amount could be significant.

"I'm trying to do my best to follow Virginia law here," said John T. Frey, clerk of the Fairfax County Circuit Court, but "people are getting the break that aren't eligible."

John T. Frey

When Virginia homeowners refinance their mortgages, they are required to pay a recordation tax. On a loan of $400,000, the tax would typically total $1,333.

The state's portion of recordation taxes soared to $669.8 million in fiscal 2006 and declined by more than half to $298.4 million in fiscal 2009. Those numbers include taxes on deeds, mortgages to buy homes, and other recorded documents, not just refinancings. Extrapolating from the state figure, in fiscal 2009, roughly $100 million more would have gone to localities.

In a refinancing, if the lender issuing the new loan is the same as the lender holding the old loan, the borrower is exempt from the tax.

The trouble is figuring out who holds the old loan.

After issuing mortgages to homeowners, banks routinely sell the IOUs to other banks or institutions such as Fannie Mae and Freddie Mac. Huge volumes of mortgages have been packaged into securities and sold on Wall Street.

Unbeknown to the borrower, the note can change hands again and again — at least electronically — while the bank that issued the loan continues to collect the monthly payments on behalf of the new owner.

The buyers of the mortgages were not required to record the note assignments in county courthouses, and, as the lending business sped up, many transfers went unfiled, county clerks say.

As a result, the clerks who process claims for the tax exemption are ordinarily unable to tell whether the lender whose name appears on the paperwork owns the loan or is merely servicing it, officials say.

"It's almost impossible to know who the actual noteholder is in this day and age," said Frey, the Fairfax County Circuit Court clerk.

Frey said he and his staff try to enforce compliance by examining the payoff statement, which shows where the proceeds of the new loan are going. But the payoff statement typically shows the servicer, not the noteholder.

Missing mortgage documents have been wreaking havoc on foreclosures. As Virginia's tax exemption shows, gaps in the public paper trail can have other consequences.

Fannie Mae, Freddie Mac and the trusts that manage mortgage pools for investors are not in the business of issuing loans at the retail level, so by a strict interpretation of the legal standard, borrowers whose loans have followed the beaten path could be ineligible for the tax break.

"Effectively speaking, virtually nobody qualifies under the letter of the law," said Daniel H. Borinsky, a settlement attorney in Woodbridge.

Joi Ionni, supervisor of land records in Arlington County, put it this way: "If we had to look at it and carry it out to that exponent, then nobody would qualify." During the fiscal year that ended June 30, Arlington granted 1,599 exemptions for refinancing with the same lender.

The system appears to be highly vulnerable to fraud and error.

Borrowers claiming the exemption — or the banks and settlement companies that submit the paperwork for them — "are not required to present any proof," Ionni said.

"If the payoff statement says 'Bank A' and the new loan says 'Bank A,' they would get the exemption," she said.

Prince William County does not require a payoff statement.

"We don't ask them to prove anything," said Kathy Cooper, records manager in the Prince William Circuit Court. "We're trusting."

Cooper said her court handles so many filings that it is unable to check the validity of a claim.

Practices vary from courthouse to courthouse. How the legal standard gets translated into action is up to the local clerks.

Bank of America executive Richard A. Bramhall said clerks across Virginia typically check whether the lender that issued the old loan is the same as the lender issuing the new loan.

"That in most cases is the end of the investigation," he said.

Virginia's auditor of public accounts is responsible for auditing county courts. Asked whether he had ever found that the refinancing exemption was granted improperly, Auditor Walter J. Kucharski said, "The answer to that is, to the best of my knowledge, no."

The long-standing state law limiting the tax exemption to refinancings with the "same lender" left that term undefined, but the Virginia attorney general's office has twice opined that "same lender" means the current holder of the debt.

There are further wrinkles where the bank that issued the original loan has been taken over by another, or where the new lender and the old lender are separate affiliates of the same company.

The Virginia Association of Realtors is calling for legislation that would make the refinancing exemption available to borrowers regardless who issues their new loan, said John G. "Chip" Dicks, the group's legislative counsel.

Maryland, the District and many other states do not have to grapple with such complexities, because their laws are different.

The Virginia law was apparently designed for a simpler era when community lenders held on to their loans, experts said.

As securitization of mortgages became the norm, and as the pace of lending became superheated, the industry increasingly skipped the step of filing note assignments in county land records. The shortcut saved time and money.

Snapshots from Arlington County land records suggest a widening gap. From 1994 to 2006, the height of the housing bubble, the number of mortgages recorded with the county rose by 85 percent. Over the same period, the number of mortgage assignments recorded with the county fell by 78 percent.

The trend coincided with the rise of a company called MERS, which went into competition with the official recordkeepers. To spare businesses the trouble and expense of filing assignments in local courthouses, MERS built a private electronic clearinghouse for loan information.

But government clerks administering the tax law cannot necessarily rely on MERS for answers. Its information, reported voluntarily by participating businesses, can be outdated or incomplete, and it allows noteholders to remain unidentified.

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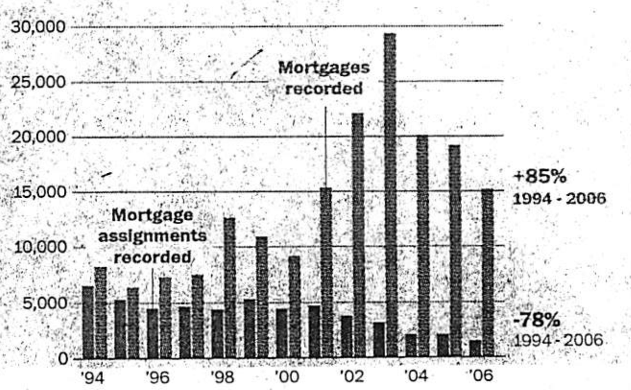
Skipping the paperwork

The number of mortgages recorded with Arlington County rose from 1994 to 2006, while the number of documents recording the sale of mortgages to investors fell. The trend suggests transfers went unrecorded as the industry tried to save time and money.



SOURCE: Arlington County Circuit Court clerk's office

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