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Virginia Supreme Court Requires Face-to-Face Meeting Prior to Commencing Foreclosures on FHA-Backed Loans

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The Supreme Court of Virginia also limits the 200-mile branch office exception to such meetings

Upholding a challenge to what appeared to be a routine foreclosure action for failure to make payments, on April 20, 2012, the Supreme Court of Virginia joined a growing list of states by ruling that a face-to-face meeting between a mortgagee and mortgagor is a condition precedent to accelerating and foreclosing upon a Deed of Trust that is insured by the Federal Housing Authority ("FHA") and which incorporates the applicable regulations of the Department of Housing and Urban Development ("HUD").

In *Mathews v. PHH Mortgage Corp.*, Record No. 110967, the homeowners filed a complaint seeking a declaratory judgment that the foreclosure sale was void because the note holder, PHH Mortgage Corp. ("PHH"), had not conducted a faceto-face meeting with the homeowners at least thirty days before commencing foreclosure proceedings. The homeowners asserted that PHH did not comply with the HUD regulatory requirements that had been incorporated by reference into a form Deed of Trust. Specifically, the homeowners cited 24 C.F.R. § 203.606, which states that for an FHA-backed loan, "[b]efore initiating foreclosure, the mortgagee must ensure that all servicing requirements of this subpart have been met," including the requirement in 24 C.F.R. § 203.604 that "[t]he mortgagee must have a face-to-face interview with the mortgagor, or make a reasonable effort to arrange such a meeting, before three full monthly installments due on the mortgage are unpaid." 24 C.F.R. § 203.604.

The homeowners alleged that 24 C.F.R. § 203.604 was incorporated into the Deed of Trust based upon the following language buried within the Deed:

> Regulations of HUD Secretary. In many circumstances regulations issued by the Secretary will limit [the l]ender's rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security Instrument does not authorize acceleration or

foreclosure if not permitted by the regulations of the Secretary.

PHH argued that the foregoing language did not clearly express an intent to incorporate HUD's regulations. Further, it argued that terms "may be incorporated into a contract by reference only if it is clear which terms are to be incorporated." *Id*. Such language, PHH asserted, did not "state explicitly which regulations are intended to be incorporated." *Id*.

The Supreme Court of Virginia disagreed with both points. First, the Court held that the incorporation language above was "clear and unambiguous" and "express[ed] the intent of the parties that the rights of acceleration and foreclosure do not accrue under the Deed of Trust unless permitted by HUD's regulations." *Id*. Moreover, the Court explained that the language clearly indicated that "[o]nly those regulations that prevent a lender from accelerating or foreclosing are incorporated by the cited language in the Deed of Trust." *Id*. Accordingly, the Court held that "the face-to-face meeting requirement is a condition precedent to the accrual of the rights of acceleration and foreclosure incorporated into the Deed of Trust." *Id*.

The Court noted that the requirement for a face-to-face meeting is subject to certain exceptions that are also contained in 24 C.F.R. § 203.604. Among those is when "[t]he mortgaged property is not within 200 miles of the mortgagee, its servicer, or a branch office of either." In *Mathews*, the Court limited this exception and made it less available to lenders, however, by interpreting a broad definition of what constitutes a "branch office" under federal regulations, an interpretation that may lead to future challenges in federal court.

PHH sought harbor in this exception by arguing that it did not have a "servicing office" within the prescribed limits. PHH relied upon a portion of HUD's website, which it contended implied that the "branch office" is to be interpreted as a "servicing office" where trained personnel are available to conduct the meeting. The Court rejected PHH's position, adopting instead the definition of "branch office" advocated by the homeowners, which includes "a place for the regular transaction of business or performance of a particular service located at a different location from the business's main office or headquarters." Indeed, the Court went so far as to state that "every type of business and service supplied by the mortgagee, including loan origination, is within [the] scope [of "branch office"]."

Acknowledging that this definition may result in meetings being held in locations where trained personnel were not located, the Court stated that "appropriately-trained staff could participate in a face-to-face meeting between the borrower and the staff of the originating office by tele- or video-conference, thereby imposing a minimal burden on the lender while furthering the loss mitigation purpose of [24 C.F.R. § 203.604] . . . ." Through this statement, the Court appears to imply that the tele- or video- conference is not in lieu of a physical face-to-face meeting, but instead is only meant to supplement such meeting being held by a potentially
untrained staff member.

The *Mathews* case appears to provide borrowers a new avenue to challenge a lender's ability to foreclose on FHA-backed loans in Virginia. A review of pending cases and anecdotal evidence from states such as Ohio, Indiana, and Michigan, confirms that the argument is being used against lenders throughout the country. As a result, lenders are encouraged to review the HUD regulations and revise their foreclosure processes for FHA-backed loans to insulate themselves from such challenges. Lenders and servicers should be aware of the additional obligations imposed by HUD and must be

satisfied prior to accelerating and foreclosing upon a deed of trust. Lenders should also review any loans currently in litigation to determine if a change in strategy is necessary in light of these newly-cemented requirements.

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