[Can mortgage lenders hold your insurance money hostage?](#)

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If your home has been seriously damaged or destroyed, your insurance company will release a check made out to both you and your mortgage lender to pay for the necessary repairs.

“Lenders have a substantial investment in the property, sometimes more than the homeowner, especially if the homeowner has made a small down payment,” says Michael Barry, vice president of media relations for the Insurance Information Institute in New York City. Mortgage lenders have an equal right to the insurance check to ensure repairs are made, says Barry.

Yet, while Michael Northagen, vice president with Wells Fargo Home Mortgage in Minneapolis, Minn., agrees, saying “the desire of the [mortgage] lender is always to have repairs made to a property,” a consumer advocacy group has come out and said otherwise.

A small number of homeowners who lost their homes last year to the wildfires in Bastrop, Texas, reported that their mortgage lenders made them pay down or pay off their mortgage balance with insurance money, instead of applying the funds towards rebuilding.

Insurance money used to pay down mortgages

According to United Policyholders, a consumer advocacy group for insurance customers based in San Francisco, approximately one-third of the homeowners who responded to the group’s post-disaster survey said their lender wanted some or all of their insurance money to be used to reduce their mortgage balance before releasing funds for rebuilding.

“We’re continuing to monitor these complaints and are working with the Texas Attorney General’s investigation,” says Amy Bach, executive director of United Policyholders. “Three homeowners gave us additional information and all three said they were up-to-date on their mortgage payments."

Bach says one of the homeowners received the remaining balance of the insurance proceeds after her loan balance was paid down, but the other two had their entire insurance check applied to their mortgage. The homes of all three were completely destroyed.

By all accounts, what has been reported in Texas isn't a common occurrence. Both Northagen and Barry say it would be extremely unusual for a lender to require homeowners to pay down their loan balance with insurance funds before they could make needed repairs, since it is in the lender's best interest to have the property restored. Northagen says this might only occur only if a borrower is seriously delinquent or in foreclosure. Neither Northagen nor Barry has ever heard of this happening to borrowers who are current on their mortgage.

Mortgage lenders and insurance claims

Northagen says that if homeowners haven't contacted their mortgage lender or servicer shortly after their home was damaged, receipt of a check made out to both lender and homeowner should trigger you to act.

"If the insurance claim is less than $15,000 and the loan is current, the servicer will usually endorse the check and release the funds to the homeowner with minimal documentation such as a photo ID and a copy of the insurance adjuster's worksheet," says Northagen. "About 60 percent of the time, this is how claims are handled."

However, Northagen says the other 40 percent are larger than $15,000 and require monitoring by the mortgage lender.

"Typically, for a larger claim, the lender becomes more intimately involved with the repair process," he says. "The lender would need to see the contractor's estimate and a W-9 document for reporting purposes. Under these circumstances the lender would put the insurance funds in escrow after getting the borrower's endorsement and then would release the funds in three installments."

On a $30,000 claim, for example, the first $10,000 would be given to the homeowner to pay the contractor when the claim is first documented, according to Northagen. The lender then pays for an inspection when the work is approximately 50 percent complete and then releases the second installment. The final payment is made after another inspection ensuring that the repair is complete.

Delinquency changes everything

Northagen says that borrowers who are current on their payments should experience the same process regardless of whether their property was entirely destroyed or not. Even borrowers who are in default normally will have their insurance claim handled the same way as long as they are working with the lender on a repayment plan.

“If the borrower [in default] is still living in the home and is making progress toward repayment and the investor is OK with it, we will release the insurance benefits so repairs can begin,” says Northagen.

“If the borrower is severely delinquent, we handle the situation on a case-by-case basis. We try to work with our customers, but ultimately, if the borrower is not cooperating and not returning messages or is no longer living in the home, the servicer may ask to have the insurance proceeds applied to the loan balance. However, this happens in a relatively small number of cases.”

Getting help

Barry says that homeowners who are having trouble accessing insurance funds should go directly to their mortgage lender rather than to their insurance company.

“When you have a loss, it’s always a good idea to notify your lender so that it’s not a surprise,” he says. “It’s better if you tell them what happened rather than them hearing it from the insurance company.”

Note: Investigations are still ongoing into why certain Texas homeowners had their insurance money applied to their mortgage balance instead of towards rebuilding. We’ll be sure to update this story when we learn more.)
About the author:

Michele Lerner, author of “HOMEBUYING: Tough Times, First Time, Any Time”, has been writing about personal finance and real estate for more than two decades for a variety of publications and websites including Investopedia, Insurance.com, HSH.com, SavingsAccount.com, National Real Estate Investor magazine, The Washington Times, Urban Land magazine, NAREIT's REIT magazine and numerous Realtor associations.