

## Mortgage Wraps: Handling The Escrow Account

In a mortgage wrap or subject to/assumption transaction, the escrow account held by the wrapped lender needs to be reviewed. This escrow account holds the funds accumulated by the monthly (one-twelfth) payments by the owner for the annual property taxes and hazard insurance that will come due.

In a conventional sale, these are prorated between the buyer and seller. The seller pays the buyer for the months they lived there and then the buyer will pay all amounts when due.

Let's say it is July when the sale is occurring. The escrow account should have seven months of escrow payments. The escrow account may be more than this, less than this or exactly correct. An escrow account analysis needs to occur to find out which exists. Ask for this from the bank.

Wrap Transaction: In a mortgage wrap deal, the seller will owe 1/12<sup>th</sup> for each month they owned the property – same as usual. However, the escrow account may have all of these funds, some of them or more than this amount. This needs to be confirmed and any shortage or overage needs to be corrected via a debit or credit on the HUD.

Sub To/Assumption: The exact same analysis and action occurs. However, if the seller is distressed (foreclosure, behind on payments, etc.) and the investor/buyer is to pay for all costs to close, this proration will not occur. The buyer pays for all escrow shortages.

The Problem: If the investor does not bring the escrow current on the sub to purchase and then re-sells to an end user buyer via seller finance wrap, this will be a problem. The lender will eventually adjust the monthly payment to recover the escrow shortage monthly. Thus, the buyer's payment will go up more than what was discussed/promised/contracted. This will cause the deal to fail.

The Lesson: The investor needs to always ask for escrow account history/status when buying or selling a wrap or sub to and make adjustments accordingly.

The Lesson #2: Always close with an experienced title office and experienced escrow officer/team to help you navigate these issues.

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