Mortgage Bankers Association of Puerto Rico

February 1, 2018

Mr. Daniel Rogers III, Director
HUD Atlanta Homeownership Center
U.S. Department of HUD
Atlanta, GA 30303

Re: Puerto Rico's state law exception to HUD's policy on community property states and the debts of a non-borrowing spouse

Dear Mr. Rogers:

We have been reviewing the Department of Housing and Urban Development's Single-Family Housing Policy Handbook, "SFHP Handbook", and we would like to present our legal opinion regarding the following question:

Is it acceptable to omit the obligations of a non-borrowing spouse in Puerto Rico, if there is a prenuptial agreement in place?

The analysis contained herein is based exclusively on Section II (A) of the SFHP Handbook and Puerto Rico's current rule of law.

I. LEGAL BACKGROUND

A. SFHP Handbook and FHA's Rules Regarding Non-Borrowing Spouse's Debt

The Federal Housing Administration, hereinafter "FHA", was created on June 28, 1934, by the National Housing Act of 1934, Pub. L. 84-345, with the intent to regulate the rate of interest and the terms of mortgages it insured, in order to improve housing standards and conditions, provide an adequate home financing system and stabilize the mortgage market. Later, Congress created the United States

Department of Housing and Urban Development, hereinafter "HUD", a cabinet-level agency established on September 9, 1965, by the Department of Housing and Urban Development Act, Pub. L. 89-174, with the mission to create strong, sustainable, inclusive communities and quality affordable homes. With the enactment of this Act, the Federal Housing Administration became part of HUD's Office of Housing. Although, the FHA continued to insure mortgage lenders against losses from default by providing insurance policies on a home loan's unpaid balance, this insurance came with the demand for strict compliance with numerous FHA requirements scattered through various handbooks, mortgagee letters, housing notices and other policy documents. In an attempt to combine all FHA requirements into one consolidated and authoritative source of single-family housing policy, on March 18, 2015 the HUD released the SFHP Handbook which contains relevant information regarding processes such as loan origination, underwriting, closing and post-closing, amongst other requirements. The SFHP Handbook supersedes, in part or in whole, many of the previously issued handbooks, mortgagee letters and housing notices, and went into effect on September 14, 2015.

Specifically, Section II (A) of the SFHP Handbook provides the origination, underwriting, closing, post-closing, and endorsement standards and procedures applicable to all single-family mortgages insured under Title II of the National Housing Act, Pub. L. 84-345, with exception of the Home Equity Conversion Mortgages (HECM). Therefore, to obtain an FHA insurance on these mortgages, the mortgagee must fully comply with all the standards and procedures stated in this Section. It is important to point out that the SFHP Handbook explicitly recognizes that all information and documentation required in the Handbook, as well as any other incidental information or documentation related to those requirements, will be relevant to the mortgagee's approval decision. Section II (A)(1)(a)(i) of the SFHP Handbook. This includes the information and documentation required and pertaining to a non-borrowing spouse in community property states. In light of this, the SFHP Handbook allows mortgagees that need to further support an approval decision to "obtain additional explanation and documentation, consistent with information in the mortgage file to clarify or supplement the information and documentation submitted by the Borrower". Id.

As part of the mortgage application and initial supporting documentation requirements, the SFHP Handbook demands that mortgagees obtain the borrower's "initial complete, signed *URLA* (Fannie Mae Form 1003/Freddie Mac Form 65) and page two of form HUD-92900-A before underwriting the

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mortgage application". Section II (A) (1) (a)(i)(B) of the SFHP Handbook. If the borrower resides in or the property to be purchased is located in a community property state, the SFHP Handbook further mandates that the mortgagee includes "the debt of a non-borrowing spouse on the URLA".

Section II (A) (1) (a) (i) (B) (1) of the SFHP Handbook. That is, the "debts owed by a spouse that are not owed by, or in the name of the Borrower". FHA Single Family Housing Policy Handbook Glossary, *Non-Borrowing Spouse Debt*, https://portal.hud.gov/hudportal/documents/huddoc?id=40001gaHSGH.pdf. Specifically, the SFHP Handbook states that:

> If the Borrower resides in a community property state or the Property being insured is located in a community property state, debts of the non-borrowing spouse must be included in the Borrower's qualifying ratios, except for obligations specifically excluded by state law.

Sections II(A)(4)(b)(iv)(F)(2) and II(A)(5)(a)(iv)(E)(2) of the SFHP Handbook. This requirement takes into consideration that in community property state each spouse has an automatic half interest in the property and debts acquired during marriage. Therefore, the non-borrowing spouse's debt must be verified and documented, and the mortgagee must "make a note in the file referencing the specific state law that justifies the exclusion of any debt from consideration". Sections II(A)(4)(b)(iv)(F)(3) and II(A)(5)(a)(iv)(E)(3) of the SFHP Handbook.

In these cases, the mortgagee must also obtain the "credit report for a non-borrowing spouse who resides in a community property state, or if the subject Property is located in a community property state". Sections II(A)(4)(b)(i) and II(A)(5)(a)(i) of the SFHP Handbook. The Mortgagee must obtain a credit report for the non-borrowing spouse in order to determine "the debts that must be included in the liabilities" when using the TOTAL Mortgage Scorecard, or the "debts that must be counted in the DTI ratio" when manually underwriting the borrower. Sections II(A)(4)(b)(iv)(F)(3) and II(A)(5)(a)(iv)(E)(3) of the SFHP Handbook. Nonetheless, in any case, the "non-borrowing spouse's credit history is not considered a reason to deny a mortgage application". Sections II(A)(4)(b)(iv)(F)(2) and II(A)(5)(a)(iv)(E)(2) of the SFHP Handbook.

Altogether, this information will be used in evaluating the liabilities and debts to determine creditworthiness, and calculating the borrower's qualifying

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ratios, when underwriting the borrower manually or using the TOTAL Mortgage Scorecard. Nonetheless, the SFHP Handbook clearly recognizes that state law can pose as an exception to furnishing debt information regarding the non-borrowing spouse. It is important to emphasize that this requirement only affects borrowers in states with community property laws where each spouse is entitled and liable for half of all property held in common in the marriage.

B. Matrimonial Regimes, Separation of Property and Community Property

In most common law countries, the default and only matrimonial regime is the common law property system or separation of property. This system is based on the premise that each spouse is a separate individual with separate legal and property rights, and thus all property, pre-marital or marital, is owned separately. As opposed to this, community property systems are premised on the theory that each spouse contributes labor, and in some states capital, for the benefit of the community, and shares equally in the profits and income earned by the community. Under this system, each spouse owns and automatic 50% interest in all property acquired during the marriage, regardless of which spouse acquired the community property. Spouses in community property states are also considered to share debts and hence, creditors of spouses may be able to reach all or part of the community property, regardless of how it is titled, to satisfy debts incurred by either spouse. See Internal Revenue Manual, *Basic Principles of Community Property Law*, https://www.irs.gov/irm/part25/irm_25-018-001.html#d0e127.

Whether property is classified as common law property or community property depends on state law. While in the United States a total of forty-one jurisdictions utilize the common law property system, the community property system has been adopted in eleven jurisdictions including Arizona, California, Guam, Idaho, Louisiana, New Mexico, Nevada, Puerto Rico, Texas, Washington and Wisconsin. See Internal Revenue Manual, *Basic Principles of Community Property Law*, https://www.irs.gov/irm/part25/irm_25-018-001.html#d0e127. This is not to say that the community property states do not provide for common law property regimes. That is the case of Puerto Rico.

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C. Matrimonial Regimes in Puerto Rico and Prenuptial Agreements

Puerto Rico's Civil Code defines marriage as:

> a. civil institution, originating in a civil contract whereby a man and a woman mutually agree to become husband and wife and to discharge toward each other the duties imposed by law. It is valid only when contracted and solemnized in accordance with the
>
> provisions of law, and it may be dissolved before the death of either spouse only in the cases expressly provided for in this title. […]

Article 68 of Puerto Rico's Civil Code, 31 L.P.R.A. § 221. This type of special contract entails a series of economic consequences for the contracting parties that will depend on the matrimonial regime to which the spouses submitted. In Puerto Rico, there are two types of matrimonial regimes, the one produced by virtue of conjugal partnership contracts or prenuptial agreements, including but not limited to separation of property, and the one created by law, also known as community property regime or *sociedad legal de gananciales*.

On one hand, future spouses may stipulate the rules and conditions that will govern present and future assets, or regulate the pecuniary interests arising from the relationship through prenuptial agreements. Guadalupe Solís v. González Dieruz, 172 D.P.R. 676, 682 (2007). Prenuptial agreements are not matrimonial regimes themselves, but vehicles to establish the regime to which the future spouses will be subjected, without it being limited to the total separation of property. Therefore, this special type of agreement allows future spouses to establish an extensive variety of clauses and conditions, provided that they do not contravene law, moral or public order. Article 1268 of Puerto Rico's Civil Code, 31 L.P.R.A. §3552. *See also*, Guadalupe Solís v. González Dieruz, 172 D.P.R. 676, 682 (2007); S.L.G. Irizarry v. S.L.G. García, 155 D.P.R. 713 (2001). In fact, prenuptial agreements can regulate, amongst other things, the rights of the spouses on their respective properties; the rights to the profits made by them during the marriage; the interests of the children and the family; the interests of the third parties that contract with either of the spouses, and, ultimately, the economic and social interest of the marriage. Guadalupe Solís v. González Dieruz, 172 D.P.R. 676, 683 (2007); Gil Enseñat v. Marini Román, 167 D.P.R. 553 (2006). In

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exercising this power, future spouses may opt for various economic regimes recognized by our legal system, such as: (a) total separation of property; (b) separation of property with a share of the profits; (c) community property; (d) a rejection of the community property, or (e) any other regime. Guadalupe Solís v. González Dieruz, 172 D.P.R. 676, 683 (2007); Domínguez Maldonado v. E.L.A., 137 D.P.R. 954 (1995). Per Puerto Rico's Civil Code, this type of contract must be executed before marriage and, "[a]fter marriage has been celebrated, the marriage contract executed prior thereto cannot be changed, whether present or future property is involved". Articles 1267 and 1272 of Puerto Rico's Civil Code, 31 L.P.R.A. §3551, 3556. It is also required that prenuptial agreements, and modifications made, be contained in a public instrument and be executed before marriage. Article 1273 of Puerto Rico's Civil Code, 31 L.P.R.A. §3557.

On the other hand, in the absence of a prenuptial agreement relating to property, it shall be understood that the marriage was contracted under the community property regime, Puerto Rico's default legal regime. Article 1267 of Puerto Rico's Civil Code, 31 L.P.R.A. §3551. *See also*, Maldonado v. Cruz Dávila, 161 D.P.R. 1, (2004). The community property regime can also be chosen, either explicitly or implicitly, in a prenuptial agreement. In any of these cases, each spouse owns a present undivided one-half interest in all the property acquired by the community and, unless specifically exempted, everything acquired by a spouse during the existence of a community is presumed to be owned equally by both spouses.

It is precisely because the lack of a prenuptial agreement implies that the marriage is contracted under the community property regime, that the Supreme Court of Puerto Rico has established that stipulations contained in prenuptial agreements must be clear and precise. In these cases, said provisions must be interpreted strictly. Guadalupe Solís v. González Dieruz, 172 D.P.R. 676, 684 (2007); Vilariño Martínez v. Registrador, 88 D.P.R. 288 (1963). Thus, when a specific property regime is clearly established in a prenuptial agreement, no further regime modification is allowed.

On more than one occasion, the Supreme Court of Puerto Rico has considered whether the behavior and acts of the spouses during the marriage has the potential of modifying the property regime agreed upon through the prenuptial agreement. Such a determination would contravene the statutory doctrine that establishes that any modification to the prenuptial agreement must take place before the marriage. Domínguez Maldonado v. E.L.A., 137 D.P.R. 954, 961 (1995). In spite of this, in Umpierre v. Torres Diaz, 114

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D.P.R. 449 (1983), the Supreme Court of Puerto Rico determined that the prenuptial agreement under controversy was merely an list of the private property each spouse held and that the parties conducted their marriage as a community property regime. In this case, it was clear that, even though the parties executed a prenuptial agreement, they did not establish the property regime that would govern the relationship. Consequently, as the spouses did not rule out a community property regime, and acted as if the property belonged to both, it was reasonable to conclude that a community property regime was in place.

On the contrary, in Domínguez Maldonado v. E.L.A., 137 D.P.R. 954 (1995), the Supreme Court of Puerto Rico ruled that the parties to the case had granted a prenuptial agreement in which the community property regime was expressly rejected. Therefore, to rule in favor of the petitioner's contention that the behavior and acts of the couple during the marriage were constitutive of a community property regime, would imply a jurisprudential variation of the statutory doctrine regarding prenuptial agreement modifications. A similar result was achieved in Maldonado v. Cruz, 161 D.P.R. 1 (2004), where the Supreme Court of Puerto Rico established that the couple had expressly rejected the community property regime in the prenuptial agreement and, instead, established a total separation of property regime. In this case, the Supreme Court determined that, irrespective of whether the spouses had engaged in community property regime like behavior, the total separation of property agreed upon through the prenuptial agreement prevented the creation, by judicial fiat, of a community property regime. Even more so, the Supreme Court explained that the fact that the spouses complied with their legal obligation to contribute to family expenses such personal expenses, mortgage payments, home improvements and entertainment expenses, was not at odds with the existence of a separation of property regime. Maldonado v. Cruz, 161 D.P.R. 1, 29 (2004).

The MBA of Puerto Rico rejects that Puerto Rico be singled out to force applicants for an FHA insured mortgage loan to include the non-borrowing spouse's debts in the loan application in all cases, including when there is a pre-nuptial agreement clearly adopting the complete separation of property. The community property regime is the default regime in Puerto Rico, when the parties do not agree otherwise in a Pre-Nuptial Agreement.

HUD Handbook 4000.1, FHA Single Family Housing Policy Handbook, at Part II.A. establishes uniform standards and procedures that mortgagees must follow from origination through post-closing/Endorsement of FHA insured

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mortgages. The uniformity of standards and procedures applies to all mortgagees under the jurisdiction of all the Homeownership Centers (HOC). Sections II.A.4.b.iv. (F). (2). And II.A.5.iv. (E).(3) provide that in community property states, the non-borrowing spouse's debts must be verified and documented and the mortgagee must make a note in the file referencing the specific state law that justifies the exclusion of the debt from consideration. Emphasis supplied. These are standard procedures that no HOC is authorized to change. Allowing HOCs to each establish its own standards and procedures in different jurisdictions within their region would result in anarchy. This is contrary to the spirit of the handbook. The exclusion of Puerto Rico from following the cited standards and procedures is both discriminatory and unjustified. The Puerto Rico Civil Code provides for the separation of property and debts for each spouse when there is a pre-nuptial agreement establishing such conditions. See Civil Code articles and jurisprudence previously cited.

Article I and Amendment V and XIV of the U.S. Constitution provide for the equal protection of the law and prohibit the passing of laws that impair the obligations under legally binding contracts. The Constitution of the Commonwealth of Puerto Rico has similar provisions and we are all U.S. citizens. Any administrative directive that is contrary to the Constitution is null and void an unenforceable.

In Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc., 135S. Ct. 2507 (2015) the Supreme Court of the United States ruled that "Disparate Impact claims are cognizable under the Fair Housing Act". It is the consequences of actions, not the mindset (or intent) of the actors which determine disparate treatment. Denying Puerto Rico residents, the right to exclude the debts of a non-borrowing spouse, when there is a local law allowing for the separation of property and debts, results in disparate treatment against a U.S. citizen by reason of place of residence within the United States and by reason of marital status. Those some citizens would not be discriminated if they were single and/or lived in other jurisdictions within the United States.

III. RECOMENDATIONS

It is clear that the administrative provision contained in the SFHP Handbook with regards to community property states and the inclusion of the debts of the non-borrowing spouse in the borrower's qualifying ratio, acknowledges a state law exception. By means of this exception, the SFHP Handbook

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recognizes that there may be some situations in which said administrative requirement could conflict with local state rules. It is our opinion that said conflict exists in the case of Puerto Rico.

While Puerto Rico's default legal matrimonial regime is community property, it is not correct to assume that it is the only matrimonial regime obtainable or that all married couples are automatically and unequivocally subject to it. Even more, other matrimonial regimes allow for different legal frameworks in which, amongst other things, the home a married couple purchases is not necessarily owned jointly. Hence, in our view, Puerto Rico shouldn't be considered a community property only state for HUD purposes. This limited classification has the effect of disregarding Puerto Rico's matrimonial regime system as a whole, paying attention only to a fraction of it. In its place,

HUD's provision should emphasize on the matrimonial regime to which the borrower is subjected, and not on the type of property state in which the borrower, or the property being insured, is located.

Even if Puerto Rico's classification as a community property state remains unchanged, the possibility of legally adopting other matrimonial regimes should be sufficient to activate the exception to the SFHP Handbook provision in cases where a prenuptial agreement rejects the community property regime or adopts a different system. In relation to this, it is important to point out that both Puerto Rico's Civil Code and Supreme Court have recognized prenuptial agreements as a legal and valid contractual property regime subject to the provisions stated by law. Yet more, once executed, prenuptial agreements are considered immutable and the law of the parties.

Therefore, if a couple grants a valid prenuptial agreement expressly rejecting the community property regime, or establishing a different matrimonial regime such as total separation of property, there is no reason as to why they should be administratively subjected to comply with tougher underwriting rules and requirements set forth by HUD in community property states. This, even more, when a valid prenuptial agreement establishing a regime of total separation of property could effectively prevent that a non-borrowing spouse's financial issues cause the property to have a lien placed on. All of this, would force the contractual parties to act in contravention to the valid legal agreement entered before marriage and would suggest an administrative variation to the established statutory doctrine regarding prenuptial agreements and their modifications.

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Mr. Daniel Rogers, Director
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In light of the abovementioned, we find that it would be acceptable to omit the obligations of a non-borrowing spouse in Puerto Rico whenever a valid prenuptial agreement establishing a matrimonial regime other than community property is in place. Nonetheless, since exceptions to HUD'S rule must be justified in the file, it would be necessary to reference the specific state law that leads to the exception and, to provide a certified copy of the prenuptial agreement to prove the matrimonial regime established.

If you need further information, do not hesitate to contact us at your convenience. Please, accept our gratitude for your collaboration and prompt response.

Cordially,

Mortgage Bankers Association of P. R.

Dimas Rodriguez-Rosado
President

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