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By John Chiles  
FEB 11, 2014

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#### COMPLIANCE MATTERS

## FHA Flood Coverage May Go Beyond Federal 'Minimum'

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The Eleventh Circuit Court of Appeals held in *Faire Feaz v. Wells Fargo Bank, N.A., et al.*, No. 13-10230 (11th Cir. Feb. 10, 2014), that a lender may require a borrower who has a federally-insured mortgage to obtain more flood insurance than the amount required under federal law.



Feaz had obtained a mortgage loan that was guaranteed by the Federal Housing Administration ("FHA"). Feaz's mortgage contained the following covenant, which is required by federal law for all FHA-guaranteed mortgages:

**Fire, Flood and Other Hazard Insurance.** The borrower shall insure all improvements on the property, whether now in existence or subsequently erected, against any hazards, casualties, and contingencies, including fire, for which lender requires insurance. This insurance shall be maintained in the amounts and for the periods that lender requires. The borrower shall also insure all improvements on the property, whether now in existence or subsequently erected, against loss by floods to the extent required by the Secretary.

When Feaz originally obtained her loan, she obtained insurance in an amount greater than her loan's principal balance but less than her home's replacement value. Feaz's loan was subsequently assigned to Wells Fargo Bank, N.A. ("Wells Fargo"). Wells Fargo did not require Feaz to increase her flood insurance coverage when it initially acquired her mortgage. However, four years later, Wells Fargo sent her a letter entitled "Flood Insurance Coverage Deficiency Notification" in which it instructed Feaz to substantially increase her flood insurance coverage. When Feaz failed to comply, Wells Fargo obtained [force-placed flood insurance](#) for her home.

Feaz filed suit against Wells Fargo, alleging that it had breached the mortgage by requiring her to obtain more flood insurance than that required by federal law. Specifically, Feaz argued that the standard-form covenant acted as a ceiling on the amount of flood insurance Wells Fargo could require her to obtain. She also brought claims for breach of the duty of good faith and fair dealing and breach of fiduciary duty. Wells Fargo moved to dismiss the complaint, arguing that the standard-form covenant acted as a floor, and not a ceiling, on flood insurance. The United States District Court for the Southern District Alabama had held in favor of Wells Fargo, dismissing Feaz's complaint.

Affirming the decision below, the Eleventh Circuit held that the standard-form covenant unambiguously makes the federally-required flood insurance amount the minimum a borrower must have, not the maximum. Employing traditional contract interpretation principles, the Eleventh Circuit noted that the standard-form covenant allows a lender to set the required insurance for "any" hazards, including floods. The sentence regarding the federal requirement, the court noted, imposes a "a separate and independent requirement that the borrower maintain the federally required minimum



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amount of flood insurance in addition to—not in lieu of—what the lender requires.” This interpretation, the court noted, is consistent with the provision in the mortgage that allows the lender to do whatever is necessary to protect the value of the property.

The court further noted that its interpretation was consistent with the overall statutory scheme. For instance, one HUD regulation governing federally-subsidized flood insurance requires borrowers in “special flood hazard” areas to obtain flood insurance in an amount “at least equal to either the outstanding balance of the mortgage. . . or the maximum amount of the NFIP insurance available with respect to the property improvements, whichever is less.” 24 C.F.R. § 203.16a(c) (emphasis added). The words “at least,” the court noted, are consistent with a lender being permitted to require more insurance than HUD requires.

Moreover, the court noted that interpreting the standard-form covenant as imposing a ceiling would undermine the purpose and efficacy of the regulatory scheme. When a borrower defaults on an FHA-guaranteed mortgage, the lender conveys the mortgage to the FHA and collects on the guarantee. However, the FHA prohibits lenders from collecting until it repairs the damage or deducts the cost of repair from insurance benefits. If insurance were limited to the amount required by HUD regulations, a lender may have to pay more for repair than it could collect in insurance benefits. This would likely make many lenders reluctant to offer FHA-insured mortgages in high-risk flood areas.

Since there was no underlying breach of contract, the court dismissed Feaz’s claim for breach of the duty of good faith and fair dealing. The court also dismissed her breach of fiduciary claim, holding that Alabama law does not impose a generalized fiduciary duty upon lenders.

*Burr & Forman LLP attorneys Frank Springfield and Jordan Teague also contributed to this blog.*

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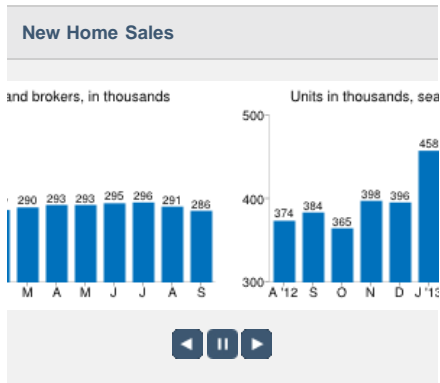
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