Care Is Key In Forbearance Accord

Observing that forbearance agreements are perhaps the main tool of the loss-mitigation process, our ***Servicing Management*** article of November 2000, "Forbearance Agreement Guide," highlighted the need for carefully written agreements and then reviewed the meaning and effect of basic recommended provisions.

We noted the obvious, though, that there were other circumstances and other clauses that could be considered. This exploration will focus first upon those additional clauses, then upon alternate scenarios.

Late charges are a typical component of sums due upon a defaulted mortgage. In most states, however, late charges accrue only up to the moment of acceleration, and not beyond. And this makes good sense because late charges are deemed compensation for the cost of pursuing tardy remittances. Once the mortgage debt has been accelerated, periodic payments will not be accepted, so there is no cost attendant to their individual collection.

Applying late charges

A forbearance agreement, however, in essence allows renewal of those periodic payments (albeit in differing amounts and times), suggesting that they should yield late charges. Do they?

Even though a good argument can be made that late charges certainly should be validly applied under the circumstances, it is unclear. To avoid any possible issue or dispute, inclusion is recommended in the forbearance agreement of language providing that late charges applicable to all monthly sums being repaid and all late charges accruing during the lifetime of the agreement are due and collectible.

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Particularly when mortgage arrears are substantial, and when the period of default is lengthy, how the sums paid pursuant to the forbearance are to be applied becomes critical. Those amounts can be allocated either according to the loan documents (if addressed there) or the record-keeping and computation requirements of the particular servicer. The servicer would usually prefer payments to be applied first in reduction of various charges and advances, then to interest, and only then to principal.

> *A forbearance agreement spelling out that all late monthly sums and late charges are payable can prevent problems during a default process.*

BY BRUCE J. BERGMAN
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Language referring to allocation of sums necessary to protect the mortgage can also be essential. The forbearance agreement would be of little value if the property were lost due to, for example, a failure to pay taxes. Likewise, in the case of a junior mortgage, advances may be required to keep a prior mortgage current. Hence, how the servicer is empowered to apply the monies paid is worthy of inclusion in the forbearance agreement.

Because the need for a forbearance agreement presupposes that the borrower is unable to reinstate in one lump sum, it should be recognized that there is no obligation upon the servicer's part to enter into such an agreement. At liberty to reject a request for a forbearance, a servicer is just as free to impose such new or additional requirements as are legal and as prudent business decisions may suggest.

So, if the subject mortgage is at a rate below the market, a lender or servicer might wish to increase the yield, in which event it must be in the stipulation. It has to be noted, though, that any encumbrances junior to the subject mortgage are not bound to that increase. Accordingly, their permission must be obtained - in writing - if an increase in the interest rate is contemplated.

Interest "balloon"

Associated with a possible increase in the interest rate is the concern that the borrower might not be able to afford larger monthly payments. Were that to be the case, the monthly payment could nevertheless remain the same, with the larger interest component to be paid as a balloon at the maturity of the mortgage.

Although most first mortgagees will typically escrow for taxes, for any number of reasons it is possible that any given mortgage might not contain such a provision. Where one of the defaults was the borrower's failure to pay taxes, establishing an escrow account for the future would be a source of considerable comfort to the lender or servicer. Therefore, a forbearance agreement can establish an escrow through inclusion of appropriate language in the forbearance agreement itself.

To the extent that the forbearance agreement has made some changes in the mortgage - such as an alteration of interest rate or establishment of an escrow account (among any number of other choices) - it would be necessary for the agreement to state that the provisions survive both the agreement itself and the discontinuance of the foreclosure action. Without such language, there might be confusion as to whether the new terms were still in existence.

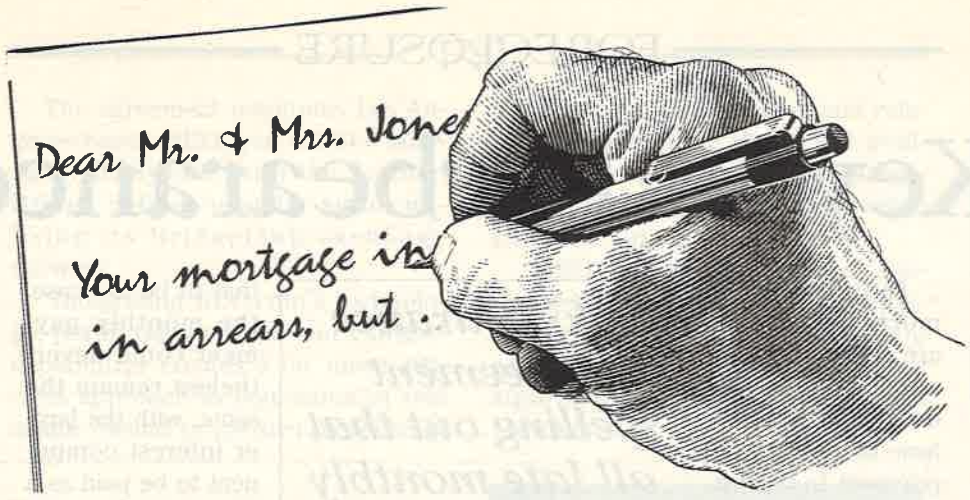
Where there are interests junior to the mortgage being foreclosed, any modification of the mortgage prejudicial to inferior positions creates potential priority problems. Even assuming the mortgage is not being modified by the forbearance agreement, insofar as extensions of time exist and various payments may look like they are being changed, it is wise to clarify for any prospective objectants that payments being made are pursuant to the forbearance agreement and are not considered as payments pursuant to the note and mortgage.

Different scenarios

A typical hallmark of a forbearance agreement is that while it halts the foreclosure action in place, pending fulfillment of the agreement's terms, it does not discontinue the action. In that way, upon breach of the agreement, the servicer is poised to continue the foreclosure the moment there is a default, avoiding expenditure of the time and expense that would be incurred if obliged to start the action all over again.

But there are occasions where the servicer might believe it necessary to continue the foreclosure even though a forbearance agreement has been signed.

Here is one scenario. Service of process is complete and the borrowers have interposed an answer that the parties recognize will be disposed of upon a motion for summary judgment. Although the borrowers do not have the financial wherewithal to meet a reinstatement payment schedule required by the servicer, they believe they can sell the mortgaged premises within a set period of time.



They are, therefore, willing to remit certain payments for an agreed period, inclusive of the legal fee to compensate servicer's counsel for preparing the agreement.

The servicer, however, is not prepared to hold the foreclosure in abeyance because the amount of payments being offered is too low. It is amenable, though, to refrain from scheduling the foreclosure sale prior to an agreed date, with the foreclosure nevertheless to continue to the point of obtaining the judgment of foreclosure and sale.

Alternatively, the borrower may have been such a chronic defaulter, or may have displayed such extraordinary irresponsibility in the past, that the servicer believes violation of the forbearance agreement is highly likely.

A more affirmative stance in a case like this could be to sign the forbearance with the noted provision that the action will nevertheless progress to the point where a sale could be set, holding in place there rather than at an earlier stage.

As part of this, the agreement could also provide that the payments made by the borrower encompass the servicer's costs and expenses to bring the foreclosure to that later stage. Then if the borrower does default, as appears likely, the servicer is that much closer to a foreclosure sale and perhaps compensated for the cost as well.

Although in the foreclosure arena most agreements will represent a clear victory for the servicer, there are occasions where expectations have to be reduced to some degree. Such an example would be a severely delayed case.

The parties recognize that ultimately the servicer will prevail, but only after incurring perhaps the time and expense of a trial. Therefore, the borrower may be willing to permit foreclosure - knowing that the case will ultimately be lost - but only in exchange for the servicer's waiver of any deficiency obligation.

Under these facts, discretion could be the better part of valor, so long as business considerations allow and a servicer could be assured of speeding to the end of the foreclosure, giving away only the ability to pursue a deficiency. Sometimes it is a path to consider and can be attended to in a forbearance agreement.

Adjourning foreclosure sale

A request to reinstate a mortgage can, of course, emerge at any time during the course of a foreclosure action. Sometimes, though, and often on the eve of sale, the borrower finally addresses his or her jeopardy and awakens to request an adjournment of the sale.

At this late stage, the borrower may not have the financial ability to reinstate, but does claim a desire to sell or refinance the property to satisfy the mortgage in *full* - if there is sufficient equity. Or the request could be for an adjournment in exchange for paying less than the full amount due on the mortgage.

The claimed desire to sell may simply be presented in terms of an intention to do so. There may or may not be a contract of sale and there may or may not be a closing date for the sale.

On occasion, the borrower's very first contact with servicer's counsel will be a call from the borrower's newly engaged attorney advising that the borrower had never been served with process, and receipt of the notice of sale was the first inkling the borrower had that the matter was in foreclosure.

Whether the assertion of lack of service is truthfully stated or not,

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the frequent mode of assault upon the pending foreclosure sale is an order to show cause claiming lack of jurisdiction. The servicer then faces a choice. Should it suffer an order to show cause with a possible delay, indefinite costs and perhaps uncertain outcome that goes with it? Obviously, the answer depends upon the circumstances.

If the servicer elects to accede to the request for an adjournment of the foreclosure sale, there are specific questions and issues to address.

Can *any* sums be obtained from the borrower to offset the costs of the adjournment? These include the cost of readvertisement, the value of interest accrual during the adjournment period and the legal expense attendant to negotiating the adjournment and committing it to writing. *Some* payment toward the balance of the mortgage is also obviously desirable.

How long is the adjournment to be? The greater its duration, the larger is the accrual of interest. To whatever extent that mounting interest is not compensated, there is a danger to the equity cushion. From the borrower's vantage point, too short an adjournment won't allow the avowed sale or refinance. Some "reasonable" period that accommodates the needs of both sides must be found.

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If the borrower is threatening to interpose defenses, jurisdictional or otherwise, adjourning the sale without eliciting the borrower's waiver of those defenses allows the threat to later be renewed when the adjourned period expires.

A forbearance agreement can cover all these possibilities and it is still another example of why such an agreement can be so meaningful in the loss-mitigation process.

It would be gratifying to note that, having completed part two of forbearance agreements, we have now covered all the variables to be encountered in any possible forbearance situation. Readers will recognize, though, that there is always room for yet more variation. That just means that servicers should be alert to the creative ways to settle a case and, through working with their counsel in the various states, this can be accomplished. SM

AGENCY UPDATES

Freddie, Fannie Lift Loan Cap

As a result of the healthy increase in the average home price over the 12-month period ending October 2001, Freddie Mac and Fannie Mae have raised the ceiling on their single-family mortgage loan limit from $275,000 to $300,700, effective this month.

The companies say the 9% change is consistent with the increase in the average cost of a home, as recorded by the Federal Housing Finance Board.

"We are delighted," says Leland C. Brendsel, chairman and chief executive officer of McLean,Va.-based Freddie Mac, adding that the new limit makes it feasible for additional hard-working families to obtain the lowest cost mortgage financing available and make the American Dream more affordable. The action also makes the lower cost of borrowing available to wealthier buyers.

Brendsel

Freddie Mac estimates that 250,000 additional families will obtain lower-cost mortgage financing. The action also makes the lower cost of borrowing available to wealthier buyers.

In addition, the company estimates that total mortgage interest savings for a borrower with a 30-year mortgage at the new conforming loan limit is approximately $37,000 over the life of the loan.

The new loan caps for mortgages on one- to four-family properties are $300,700 for mortgages on one-family properties (up from $275,000); $384,900 for mortgages on two-family properties (up from $351,950); $465,200 for mortgages on three-family properties (up from $425,400); and $578,150 for mortgages on four-family properties (up from $528,700).

Under their federal charters, Freddie Mac and Fannie Mae's maximum original loan amounts are 50% higher for first mortgages on properties in Alaska, Hawaii, Guam and the U.S. Virgin Islands.

Limits for multi-unit loans also will increase for 2002 as follows: two-family loans to $384,900; three-family loans to $465,200; and four-family loans to $578,150.

The limit for second mortgages will increase to $150,350.

The higher borrowing ceilings were expected, but not everyone in the housing industry was ecstatic about the percentage increase. Some real estate brokers in expensive markets - such as New York and California - were disappointed by the size of the increase. SM