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FORECLOSURE

Delete The 30-Day Cure Clause!

Yes, You Read That Correctly. Chronic Defaulters Can Milk The 30-Day Clause Unless You Take Bold Action

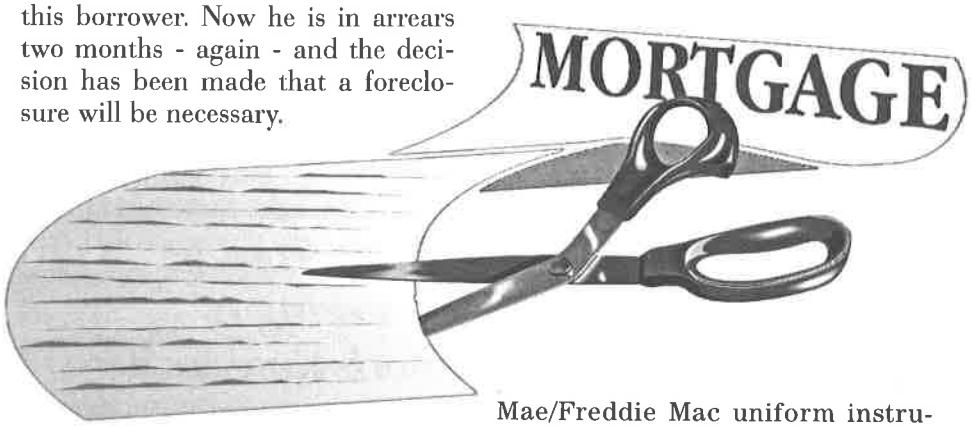
BY BRUCE J. BERGMAN

A recondite discussion of mortgage provisions to intrude upon the crushing schedule of busy mortgage servicers?

Maybe not, particularly if one assesses a scenario like this:

The borrower is a chronic defaulter. He has been late with payments every month since the mortgage originated four years ago. Obviously, he has been the subject of a flood of letters and phone calls with a new excuse each time because, apparently, his accursed existence has caused him to suffer illness, divorce and regular loss of employment - or so he has averred.

Two forbearance agreements failed and even a foreclosure - eventually reinstated - has not chastened this borrower. Now he is in arrears two months - again - and the decision has been made that a foreclosure will be necessary.



But wait! The file cannot be sent to counsel unless and until the 30-day cure letter (or breach letter, as it is also called) is mailed and the cure period expires. Naturally, that automatically grafts another 30 days' duration onto the collection/foreclosure process.

Beating the clock

It hardly need be underscored for servicers that "timeline" is one of the leading buzzwords of our day. Collection efforts and the subsequent foreclosure action are most often constrained by strict timeframes.

The government-sponsored enterprises typically are the engine driving the process and the influence is understandably pervasive: cases need to move. Costs mount with every day so progress is essential.

If adding 30 days to the methodology seems antithetical to the goal, where does it come from? The simple answer is that the requirement is found in the mortgage itself: paragraph 21 in the current Fannie Mae/Freddie Mac uniform instrument, which in turn is the basis for so many other mortgage forms. (State law will typically not mandate any prior notice before a mortgage balance is accelerated.)

If only the mortgage itself imposes the obligation to send a 30-day cure letter as a prerequisite to acceleration, lenders and servicers are figuratively shooting themselves in the foot with their own documentation. Of course, for mortgage paper sold or to be sold on the secondary market, lenders and services have no choice: the uniform instrument almost invariably must be employed. (For mortgages held in an originator's own portfolio, the form and any offending provisions it contains need not be used.)

Observing the mandate that the uniform instrument (and its 30-day cure provision) is usually inflicted upon a mortgagee leads to the underlying message of this polemic: Consider removing the cure provision from the mortgage. That means that the promulgators of the form are invited to consider a provident revision.

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Shortcoming of the clause

The shortcomings of the cure provision are manifest. It offers an excuse to too many defaulting borrowers to interpose an answer containing a defense that the cure letter was never sent. Alternatively, they can argue that although the letter was sent, it did not contain the special required language. (They might also have the opportunity to argue that the mode of transmission was incorrect.)

In judicial foreclosure states, at least, interposition of this "defense" has the potential to add many months to the case, and sometimes there may even be merit to the argument. Elimination of the provision - or modification of it - portends a saving of both time and money, assuredly magnified across a portfolio of loans. (Naturally, the more loans the greater the savings.)

The 30-day cure provision is certainly consumer-oriented, hardly offensive in theory. But too many circumstances argue against mandating the 30-day notice for every case. A good example is the regular or chronic defaulter. A necessity to send the 30-day letter (thus delaying the case on each and every occasion when lateness is protracted) seems conspicuously unfortunate.

There is yet another example. Where a borrower has died (and there is only one borrower), there is considerable futility in sending the letter. Other correspondence would probably be more effective - assuming the person to whom to write was even known.

An additional instance to consider is the case where a borrower has already revealed an absolute inability to cure a default, such as when a job is lost, savings have been exhausted and there is no family or friends to help. The cure letter will hardly be utilitarian under those circumstances.

They get better

And how about this one?

Borrower arranges with lender to make mortgage payments by debiting his account, but provides lender with an incorrect account number. When the mess that creates is discovered, a 30-day cure letter is sent. Borrower now doesn't have the funds to reinstate, so a forbearance agreement is requested and granted. Surprise! The borrower defaults on the very first payment due under the forbearance.

It is not entirely clear whether a new 30-day cure letter must be sent (it might depend upon how the forbearance agreement was written), but prudence suggests that the servicer must suffer the 30-day delay rather than later encounter a fatal defense - all the more reason for the cure provision to be banished, or at least modified.

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There are, no doubt, more than a few other examples which could be advanced, but the point should be apparent: There will be many situations where it is not at all unreasonable to forego the 30-day cure letter. Certainly in those cases, not having to first send the letter would clearly save the time and money with no detriment to the defaulting borrower - except that the ability to delay the process would have been diminished.

Even ignoring instances where the 30-day cure letter is patently unnecessary, the clause presents an apparently substantive basis for a borrower to formulate an answer in a judicial foreclosure state. It is always easy for a borrower to say "I never received the letter." Although receipt is not the ultimate determinative factor, the lender or servicer must then be in a position to prove that the correspondence was sent. That is not always so easy to do and when a court is faced with choosing between lender and borrower in a case like this, too often they may choose the side of the borrower.

Use the right letter

While experienced servicers should have a form letter that clearly meets the requirements imposed by the mortgage, there are instances where less experienced servicers did not have the proper letter in use. Still further, there is always the possibility, albeit remote, that even a skilled servicer could simply make a mistake and the letter might not be sent. Thus, the defaulting borrower who could be reluctant to submit an answer consisting solely of baseless denials can be emboldened to employ a claim of failure to send the cure letter in formulating that answer.

Besides the noted drawbacks of the subject provision, there is also an element of considerable confusion in the arena of a balloon mortgage or a mortgage which has matured by the passage of time. Must a 30-day cure letter be sent as a prerequisite to foreclosure? There is nothing to accelerate and, in a sense, nothing to cure: the balance has simply become due.

The idea of the cure provision, it would seem, is to allow a borrower to rescue the mortgage by reinstating it. That end cannot be achieved when a mortgage has reached the end of its term. Even though it might be concluded, therefore, that the cure letter is unnecessary, because it is not absolutely certain, conserva-

tive counsel would be to err on the side of caution and send the letter.

Assuming, then, that the letter will be sent, the usual language cannot apply because, among other things, there cannot be a reinstatement. The difficulty with the cure clause in the matured mortgage situation, then, is that:

- servicers are not sure what to do about it;
- they must expend some time and effort to clarify the confusion;
- if they do send the letter, it has to be modified; and
- in sending the lender, 30 days more interest accrues when it seems that such should not occur.

The GSE guidelines

Perhaps the most compelling observation about all this is that Fannie Mae requires (Announcement No. 97-11), as of Jan. 1, 1998, that no later than the 15th day after delinquency a "solicitation letter" must be sent by the servicer to the borrower, in substance advising of default and seeking to find a way to help. (Freddie Mac has similar requirements with slightly different timeframes.)

This seems like a worthy loss mitigation tool. But once that solicitation letter has been transmitted, the rhetorical question is: What value remains in imposing the sending of still another correspondence - the 30-day cure letter?

Even were there no GSE guidelines for loss mitigation and communicating with borrowers, it would only be the rarest occasion when a professional servicer would pounce to foreclosure without some calls and letters to a defaulting borrower. Notwithstanding all these arguments, should the provision nevertheless prove durable, some modification (as opposed to elimination) could be in order. Making its invocation optional with the servicer is one thought. Many servicers would use it much of the time, or at least employ it more judiciously.

Or, dispense with the obligation to send the correspondence when the special or similar circumstances reviewed here are encountered. Still another idea is to make the clause effective only for the first default or perhaps one other after that. The servicer should not be constrained to afford what is, in essence, an additional 30-day delay for borrowers who are regularly in default. Another permutation is to suspend the provision for one, two or three years after the cure letter is first sent.

Yes, borrowers deserve a chance. But they should not be given unending opportunities to abuse the privilege nor, perhaps, should servicers (or investors) suffer expensive delays in the name of perceived consumerism. SM