

Late Charges Can Amount To Big Bucks

But If You Choose To Accelerate The Mortgage, The Charges Don't Accrue

BY BRUCE J. BERGMAN

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There is not a whole lot written about late charges. Could it be that not so many people care about this seemingly minor component of the mortgage collection and foreclosure process?

The answer could be "yes." In part because not everyone contemplates late charges with the zeal of a lender or servicer, the controlling principles are sometimes obscured or misperceived.

This is perhaps understandable, if nonetheless regrettable.

The percentage factor

If a late charge due on an overdue \$500 mortgage payment is \$10 (a typical 2% late charge provision), there isn't too much to argue about - and no compelling aphorisms are likely to emerge from a lender/borrower dispute about whether the \$10 needs to be paid.

If the mortgage payment is \$3,500 and the late charge percentage is 5%, then the additional sum due for a late installment is \$175 - a more meaningful sum.

As the size of the mortgage increases, as the number of payments in arrears goes up and if the applicable late charge percentage becomes greater, then the additional amount attributable to late charges becomes more important. Certainly in a large commercial case, late charges can be significant.

In any event, across a larger servicer's portfolio the aggregate of late charges takes on considerable significance.

As noted, though, since on a case by case basis the late charges involved tend to be relatively inconsequential they are not worthy of litigation - a pleasing notion, no doubt. So, the opportunity for courts to promulgate interpretations are quite infrequent.

Then, too, the prevailing circumstance is that late charges silently accrue during the life of a mortgage.

Any borrower can be tardy on

occasion; some are late with regularity. Years later, either when the mortgage

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matures or when the property is sold, with the mortgage to be satisfied, the payoff figure will include these charges.

Since few residential borrowers keep meticulous records of their payments over the years, they will often find the accrued late charges no doubt surprising. But this component of the payoff is normally paid without necessity for litigation.

Nevertheless, late charges can be contentious when the need to foreclose arises and thus lender and borrower should be aware of their rights.

That good and understandable reasons may exist why late charges are so seldom in the judicial spotlight, that in no way diminishes the need to understand how the late charges are to be applied. This will vary from state to state where different statutes may control.

(Again, there will be a paucity of case law interpreting such statutes as may be applicable.)

Benefits of late charges

To be sure, there is considerable benefit to inclusion of a late charge provision in a mortgage.

If a payment is submitted beyond the grace period, interest is effectively lost since use of the money was delayed. Additionally, expenses are typically generated in attempting to collect overdue payments. Still further, there is usually a cost factor attendant to handling the ac-

tual receipt of tardy remittances.

There should be compensation for all this and late charges fulfill the function.

The percentage of the overdue payment that may be added on as the late charge is usually determined by state law (or federal regulation, for certain types of lenders). In New York, for example, statute (RPL s254-b) provides that a 2% late charge may be assessed for payments more than 15 days overdue. This maximum prevails for a one-to six-family dwelling. No maximum is imposed for property used for other than residential purposes or where it is intended to be occupied by more than six families.

Just as there are variables in New York, so too would there be variables among and within the other states.

The acceleration twist

Probably the really meaningful issues surrounding late charges arise upon acceleration. The point is best explained by the following example:

Borrower Tardi fails to remit a mortgage installment of \$1,000 due on Jan. 1. The mortgage contains a usual late charge provision of 2% after the typical 15-day grace period. After expiration of the grace period, lender calls Tardi requesting payment of the installment together with the \$20 late charge.

Tardi does not respond and likewise neglects to send the payments

due for February and March. By March 19, and after further calls and letters, lender elects to accelerate the full principal and interest due on the mortgage.

As a result of the acceleration, the mortgage payment for April was not due. The lender elected to accelerate and has now created the right to accept nothing less than full payment of the mortgage balance. Hence, no late

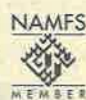
charge can attach to the April installment or any payments which would otherwise have been due thereafter.

This principle happens to be one of the most often lost in the conceptual shuffle. If upon acceleration there no longer are any installments due, then there are no payments to which an otherwise valid late charge can attach. In short, there are no late charges for payments which would have become

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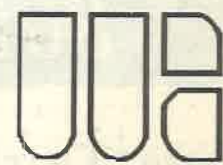
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due subsequent to the date of acceleration.

What about the accrued late charges for January through March? Astute lenders and servicers take the position that those late charges are and remain due. This is apparent both from the very words of the applicable statute and the weight of cases, few though that may be.

A court decision

The most recent case on the subject of late charges (again employing New York as an example) addresses the twist of whether a late charge attaches to a balloon payment. Although the lender was pursuing a late charge as part of the debt, the borrower resisted - contending that the late charge was really a penalty.

In reaching a conclusion, the court noted the provision that a late charge of 6 cents for each dollar overdue could be assessed "for the purpose of defraying the expense incident to handling delinquent payment." How, the court asked, might this apply to the full \$220,000, which became due on the note as a balloon payment?

Initially the court found that even if the late charge provision was a penalty - a forfeiture - it may not be favored, but it is not rendered unenforceable. Anything which is a forfeiture, though, is to be strictly interpreted to avoid that result.

Whether forfeiture or not, the late charge clause here was found applica-

ble to defaults on monthly payments engendering collection expenses, not defaults which end payments - such as failure to pay a balloon which precipitates foreclosure. That default terminated the right to cure the default.

The cost to pursue this payment would be covered by legal fees to be awarded in the foreclosure action. Construing the mortgage in any other fashion, the court found, would provide an unnecessary duplicate source of recompense for handling the account.

What is most encouraging about this case is the reaffirmation that late charges are collectible to defray the cost of pursuing late payments. We cannot suggest that the narrow focus finding late charges inapplicable to a balloon payment will be of universal effect. But the decision is well thought out enough that it may indeed be the prevailing wisdom - and it highlights the basic underpinnings of the late charge equation.

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