Ruling Likely To Help Servicers

The decision in a New York default case that resonates nationally entitles a note holder to collect interest on both past-due principal and interest.

BY BRUCE J. BERGMAN

Computing interest due on a defaulted mortgage might appear to be a mundane, unchanging task - one addressed in the normal course by a software program that, it is presumed, unerringly drives the computer to generate the numbers. Whether needed for a referee's computation in foreclosure, to compute a bid at the sale or for reinstatement or payoff, there is likely comfort in the assumption that all this is graven in stone.

But a helpful new case decided in November in New York - Spodek vs. Park Property Development Associates - tells us this isn't so and invites a review of the future calculations not only in New York, but around the country as well, to assure that mortgage investments produce a maximum yield.

In brief, this surprising new decision of New York's highest court rules that the holder of a note in default is entitled to interest on each installment from the date the sum is due on both the principal and interest portions until the date liability is fixed. (In a foreclosure action, this means until acceleration. But more on that later.)

Although the case involved a promissory note and not a mortgage, it clearly has significant application to mortgage foreclosure actions in New York. (Again, exploring what role this formulation plays in other states is well worthy of inquiry.)

Issue of interest

A part of the whole interest computation issue is the idea that the rate of interest that will apply can change during the course of a foreclosure action. To be sure, this varies among the states, but the point is enlightently noted in New York as a guide to what invites scrutiny.

Although the new ruling relates to the earliest state of mortgage default,

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its explanation will be addressed last. Assume then that a borrower is in default for some number of months so that ultimately the servicer accelerates - that is, declares the full principal balance of the mortgage due.

This accelerated balance now bears interest at what is variously called the "legal" or judgment rate - in New York, 9%. (Observe that the "note" or contact rate does not apply.)

This 9% rate prevails, however, only if the mortgage is silent about some other and usually higher rate. This is thought of as the default rate, and most mortgages will wisely make provision for it. (Without such a higher rate, there might be an incentive for a borrower to default.)

Because in New York the default interest is not a loan, it cannot be condemned as usurious. So the mortgage could denominate the default rate as 14%, 16%, 24% - or any percentage. What rate is appropriate for business purposes is a different but compelling issue. The point remains, though, that the accelerated mortgage balance can and usually does yield a higher default rate that has no limit in New York.

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In judicial foreclosure states after acceleration, the case wends it way to issuance of the judgment of foreclosure and sale. Then, the sum due reverts to yielding interest at the judgment rate of 9%. The exception to the rule is that the balance can continue to bear the default rate if the mortgage clearly states that the default rate is to survive and not merge into the judgment.

Returning to the new case, here is what it means in practical terms. A monthly mortgage payment of $1,000 is due on Jan. 1 and monthly thereafter, consisting of (for this example) $700 interest and $300 principal. (Assume that the interest rate in the note is 7%.) The payments for January, February and March are not made, so on April 10 the lender or servicer accelerates the full $100,000 balance of the loan.

As mentioned, there had never been a doubt that the accelerated $100,000 bears interest either at the note rate (7%) - or the default rate if the mortgage so provided - until issuance of the judgment of foreclosure and sale.

As to the three missed payments, interest would have been computed at the note rate on the principal only (in this example, $300) - not the interest (here, on $700). With this new case, though, interest is to be assessed on the aggregate of both principal and interest, that is, on the full $1,000 from the date each payment was due until acceleration.

One reason such a ruling was perhaps unexpected was because it looks like it might be interest on interest (compounding) that is often rejected. But it turned out really to be the interpretation of a New York statutory provision for simple interest.

The decision was also stated to be consistent with the time-honored recognition that the purpose of awarding interest is to make an aggrieved party whole - something lenders and servicers will well appreciate.

And now to the everyday consequences of all this:

- Prior to acceleration, the longer a loan is in default, the more interest it will now yield.
- How meaningful this will be on one loan is problematic - but this applies to all mortgages in any portfolio in New York. That clearly elevates its importance.
- If there is to be a reinstatement - even months or years after acceleration - because the balance would then have been de-accelerated, it would be reasonable to demand interest upon each past-due installment (on principal and interest) from the date that payment would have been due. That can become a significant amount.

There is a caveat to all this - in an equitable action in New York (foreclosure is such an action), the court retains discretion in the award of interest. So if there were some fault or delay attributable to the mortgage holder, the court would not be mandated to award interest under this new formulation.

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Such discretion, though, is rarely invoked, leading to the conclusion that the new rule should apply most of the time. So, this new case really does have meaning. That is the important story in New York.

In addition to maximizing the return in the Empire State, servicers may wish to examine like formulations for all other states in which they service loans. SM

— FYI —

Servicer To Use New Platform

Fiserv Inc. of Brookfield, Wis., has announced that **Meritech Mortgage Services Inc.**, an affiliate of Saxon Capital Inc., will use its Fiserv MortgageServ platform to support its loan servicing operation.

Meritech Mortgage Services' main business is the servicing of nonconforming residential mortgage loans. The default servicing capabilities - specifically workflow integration and collections technology within the MortgageServ core system - were critical factors in the selection process, according to **Dennis Stowe**, company president.

"Meritech was seeking a single platform incorporating both workflow productivity tools and a default management focus as part of the core platform," Stowe says. "The search led to Fiserv and the MortgageServ system."

He notes that MortgageServ is a real-time, Web-enabled, browser-based system that provides comprehensive functionality to manage a mortgage loan servicing enterprise and integrates value-added modules for information management, contact management, analytic tools and imaging.

"MortgageServ collection, default risk management and task-tracking capabilities enable non-prime servicers to better target the collection candidates that most need to be focused on, and then manage the processes involved," says **Sadu Thinakal**, Fiserv Mortgage Servicing Systems president. "This managerial control results in sustainable benefits."

Firms Agree On Resell Pact

King of Prussia, Pa.-based **SEDONA Corp.**, a provider of Web-based customer relationship management (CRM) solutions for

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