GUIDANCE FOR THE CRITICAL FORBEARANCE AGREEMENT

By Bruce J. Bergman*

No one need tell servicers why loss mitigation or settlement of foreclosure actions is a favored approach. Clarification of mechanics and details, though, are worth some scrutiny.

Begin with the thought that informality can be dangerous. A friendly, amenable phone chat with a borrower about sending some past due checks comports nicely with public relations and may be the sincere manifestation of the servicer's attitude. Even a casual letter might seem appropriate. But if there is a later dispute about just what the borrower was to do to reinstate or avoid foreclosure (or the continuation of a foreclosure) lack of a clear writing defining mutual obligations opens the door for litigation which servicers can lose. Suffice it to say, there are considerable case law decisions where courts chose to believe borrowers' versions of events.

Mindful then that whatever form the agreement takes (stipulation, standstill agreement, forbearance agreement, settlement agreement) it should be reduced to a carefully crafted writing, who should prepare it? Servicers can rely upon their counsel in the various states, but should nonetheless themselves be familiar with the structure of these documents. Certainly if drafted "in-house", knowledge of various provisions is essential.

Here are some suggested bullet points to consider.

- **LENGTH**

In a commercial mortgage situation there is more room for lengthy, complicated agreements. That need not be so in the residential case, though. A forbearance agreement can be short and yet

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fulfill the goal of protecting the servicer. Brevity is desirable also because servicers should avoid intimidating borrowers with daunting, complex documents.

- **SIGNATORS**

This concept might seem unworthy of much thought but there is nuance to it. Typically, the parties who sign are those liable for the mortgage debt and those who own the property. Usually, they are one and the same, people, thought of as "the borrowers". It might not always be that way, however. For example, if "A" and "B" are the borrowers and they sell the property to "C" and "D", unless "A" and "B" have been released upon the obligation (and an assumption agreement doesn't necessarily do that) then "A" and "B" remain liable for the debt, even though "C" and "D" own the property. ("C" and "D" would also be liable for the debt if they entered into an assumption agreement.) Then there could be guarantors who neither sign the note nor the mortgage but instead sign guarantees. When a foreclosure action is begun, most often everyone who is so threatened by the foreclosure would desire to enter into a forbearance agreement. Note that if obligors (here "A" and "B") and guarantors do not sign, and if the obligation is changed by the forbearance, those obligors and guarantors might be released from liability. If the forbearance later fails - as often occurs - loss of such liability can be unwelcome.

Then there is the scenario of a husband and wife living apart and the wife (for example), anxious to save the house, seeks forbearance. But the husband either cannot be found or spitefully refuses to do anything which might save the dwelling. The question then asked is, can the agreement be entered into solely with the wife? Because the thrust of the forbearance agreement is to remit a series of payments leading ultimately to a reinstatement of the mortgage, there should be no downside in having the wife alone sign. If the ultimate result will be reinstatement of the mortgage, everyone benefits -- including the recalcitrant husband who never wanted any part of it. So it would be difficult for him to make a fuss arising out of non-participation.

- **AUTHENTICITY OF SIGNATURES**

Stipulations which settle litigation - a forbearance agreement fits the definition - are generally treated as binding contracts which are set aside only upon exceptional circumstances such as fraud. Therefore, servicers can assume that borrowers who sign forbearance agreements are firmly bound. Assuring, then, that the borrower actually signs is important. If the signing can be accomplished in the presence of servicer's counsel, or in servicer's office if prepared "in-house", the procedure reduces the possibility of a later claim that it wasn't the borrower who signed. In the absence of such a sit down session, the signature should be acknowledged before a notary public. (Use of the notary public is recommended even if there was a direct meeting.)

The purpose of the notary is not as a prerequisite to record the document (which is what an acknowledgment typically is for) but to help prove that the person who signed really was the borrower. Moreover, where the borrower is represented by counsel, having the attorney sign in that capacity further reduces any ability to later assert that the signature was not genuine or not volitional. (Servicers are aware of the old defense: "they made me do it".)

- **WAIVER OF DEFENSES**

Although perhaps apparent, an underlying goal of a forbearance agreement is to settle the litigation permanently. That objective is defeated if a borrower later assaults the foreclosure action should it be revived. Accordingly, an indispensable provision of a forbearance agreement is the borrower's waiver of any claimed defense to the action, waiver of the right to interpose defenses in the future and withdrawal of any defenses already in the case, such as in an answer.

- **PAYMENT AND DELIVERY**

Assuming payments are to be made over some period of time, it is recommended that the agreement set forth the dates upon which the payments are to be *received*. A common problem with remittances is that the borrower will claim it was mailed on a certain date, but the servicer has not yet received it. That creates an ambiguity as to whether the forbearance agreement is in default. Clarity arises if the agreement provides the dates upon which the payment must arrive (and by the close of business on those days) so that there is no question or issue about when it was mailed. Then the address and to whose attention the payments are to be sent should also be specified so there is no confusion in that regard.

If an initial payment is to be sent to servicer's counsel, the agreement should so provide, then noting the dates and destinations of all subsequent payments. If a portion of the payments are being applied first to legal fees and disbursements, then to late charges, then to other servicer expenses, and only afterwards to interest and principal, consider having the agreement so specify so there is no later dispute as to allocation of the funds.

- **FORM OF PAYMENT**

Because there is always a danger that a regular check could be returned for insufficient funds, thereby creating considerable disorder, a forbearance agreement should specify that payments must be made by good money order, bank or certified check, accepted subject to collection only. Moreover, because late payments would be unacceptable, provision should be made that time of all payments due pursuant to the stipulation are of the essence. (Time of the essence is a phrase of considerable legal import in most states.)

- **<u>NOTICE OF DEFAULT</u>**

This is one of the thornier, contentious issues in a forbearance agreement. Notice of a default is a typical aspect of contracts. (It is also standard in the Fannie Mae/Freddie Mac uniform mortgage instrument.) Borrowers' counsel can be expected to ask for notice if payment is late or missed. This *sounds* reasonable. A problem with defaulting borrowers, though, is the existence of the distress or mishap which led to default in the first instance. This portends the possibility, even the likelihood, of defaults under the forbearance arrangement. If notices are mandated, they may be needed with regularity. That creates a whole new collection process in the forbearance agreement itself - just what the agreement was designed to avoid in the first instance. Hence, if a servicer feels compelled to provide notice, that should be limited to perhaps a maximum of one or a few defaults, after which no notice is required. Where a borrower make defaulting under the agreement a habit, the servicer should hardly feel compelled to provide notices interminably.

- **<u>MAINTAINING THE FORECLOSURE</u>**

In contemplating whether a forbearance agreement will be honored by the borrower, servicers recognize that in some percentage of cases - probably a significant number of them - the borrower will default. In judicial foreclosure states where the actions are time consuming, it would be pointedly imprudent to discontinue a foreclosure action as soon as the stipulation was signed. Even if default did not follow instantaneously - as is sometimes the case - when ultimately there is a default, the hapless servicer is banished to begin the expensive foreclosure process all over again. The simple solution is to provide that the foreclosure action is *not* being discontinued by virtue of signing the forbearance agreement, but rather is halting in place, poised to proceed in the event of a default. This preserves considerable leverage for the servicer and allows the foreclosure to go forward without loss of time or incurrence of expensive duplication if the borrower does not keep the new promises.

- **OTHER DEFAULTS**

Although the forbearance agreement is typically focused upon monetary payments necessary to reinstate the mortgage over time, it should be recognized that there are other possible defaults upon a mortgage. So, if the borrower made all the payments under the forbearance agreement, but failed to maintain fire insurance, pay real estate taxes, neglected to keep the property in repair or defaulted on a senior mortgage, it would still be a default. Because the servicer should not be obliged to reinstate the mortgage if there are other defaults, the forbearance agreement would wisely specify that any default in maintaining the taxes or the fire insurance, or breach of any other terms or conditions of the mortgage, are deemed to be a material breach of the forbearance agreement, thereby permitting the mortgage holder to exercise its remedy.

- **ADJUSTABLE RATE MORTGAGE**

In the instance of an adjustable or variable rate mortgage, particularly when based upon indices which can change at any time, no matter how much care is exercised in reciting the payments, the calculation might not be precise at the conclusion of the forbearance period if rates have changed during the course of the agreement. Therefore, this should be accounted for by noting the fluctuating nature, stating a condition of the agreement that the borrowers pay the monthly mortgage payments accruing during the stipulation as they may vary from time to time.

- **BANKRUPTCY FILING**

Even with a forbearance agreement, a borrower still may file a bankruptcy which then stays any collection efforts. To provide a modicum of protection in this regard, and although an agreement prohibiting the filing of a bankruptcy petition would be unenforceable, a provision that should the borrower files a bankruptcy the borrower would not oppose any motion for relief from the automatic stay can be considered.

- **CONCLUSION**

It should be readily recognized that there could be a surfeit of other terms worthy of consideration in a forbearance agreement. Mortgage provisions could be modified or extended, guarantors could become bound, past due interest could be capitalized, a balloon payment could be added at the end, the lien of the mortgage could be spread to additional parcels as further security, and so on, almost without limit. The point here, though, is not the breadth of conceivable permutations, but the possibility that some very basic and relatively simple terms can aid the cause of the servicer faced with a defaulting borrower who proposes reinstatement.