Protecting The Loan — Aggression or Compassion?

By Bruce Bergman*

When a second mortgage is in default, the lender is immediately drawn by two apparently conflicting constraints. First, he has a strong obligation to protect his investment by collecting the money due — through the vehicle of a foreclosure action if necessary. There is also the pressure of a possible foreclosure of prior mortgages. On the other hand, he is motivated by natural sympathy for the party who is unable to pay, to say nothing about the public relations aspects of taking someone's property in a foreclosure. Can a balance be struck between these responsibilities? The answer is yes, although this response does not necessarily suggest any clear alternatives to foreclosure.

Initially, perhaps the best way to consider helping the borrower, is to understand briefly what the lender can do to enforce his position. Every mortgage has a due date for periodic payments, followed by a grace period — most often fifteen days. If the payment has not been made by the expiration of the grace period, the lender has virtually an absolute right to declare the **entire** mortgage balance immediately due and payable. This concept is generally referred to as acceleration and is usually accomplished by writing a letter. (There are some exceptions to this, in particular, federally funded mortgages. Also, notice may be a prerequisite in some situations. Basically, however, the proposition is correct.)

Although it may seem harsh, this right to accelerate has repeatedly been upheld by the courts. Once acceleration has occurred, the lender need not accept a tender of arrears due, but rather may insist upon **full** payment of the mortgage. If the borrower will not, or cannot, make that payment, a foreclosure may proceed to sale.

How can the lender — who is obliged to collect principal and interest — help the borrower who is in arrears? One seemingly obvious, though often neglected method, is to keep close tabs on defaults. If a lender is casual with delinquent payments, the danger is that the borrower falls so far behind that his position becomes irretrievable, thus leaving little room for graciousness on the part of the lender.

Hence, the recommendation is that the lender have a meticulous diary system. As soon as a payment is late, phone calls and letters should immediately be issued to encourage the borrower to become current. Facing the problem early and working with the delinquent party is a salutory way to avoid extended arrears which may not be susceptible to curing, especially when the mortgage yields a high rate of interest. Therefore, an apparently tough stance is really in the best interests of the borrower.

For example, suppose the borrower is now three months behind in mortgage payments of $900 per month, with arrears totalling $2,700. For every month that passes, the burden to bring the loan current becomes weightier. Frightened by this precarious situation, many borrowers refuse to face it, hoping somehow it will go away — which obviously it will not.

Assuming it is consistent with policy, the lender could suggest that the sum of $450 be added to each succeeding mortgage payment for six months, additionally factoring in late charges or interest. If the schedule can be met, the problem is solved. If $450 per month is still too onerous, it could be stretched out still further. If the borrower has the wherewithal and sincere desire, ultimately the problem will be resolved.

If still there is no way for arrears to be paid, discussion could be had with the borrower to seek a loan from a family member or friend to tide him over. Even a refinance with the lender may be appropriate if the standards of equity and/or credit can be met. Should the lender wish to wait, another possibility would be for the borrower to seek refinancing from another institution for a longer term.

But often, even the most vigorous and sage efforts to collect arrears are not fruitful. When that happens, the situation cannot be ignored because the continual mounting of interest, together with possible physical neglect of the property, only jeopardizes the value of the mortgage security.

At this juncture, the lender could suggest that the borrower sell the property to satisfy the mortgage, thereby at least recouping some of the equity in the property. For example, assume there is a mortgage reduced to $100,000 on a house now worth $150,000. The borrower is six months behind in mortgage payments of, say, $1,500 per month. He simply does not have the cash flow to make up arrears or the credit to refinance. Should the lender rush to foreclosure, the result is that the house is sold under distress sale circumstances. While the lender should then be paid in full, the borrower may receive little or nothing out of a surplus, with the added indignity of being thrown into the street.

If, however, the house **can** be sold within a reasonable time for somewhere around the market price, the lender's mortgage is satisfied **and** the proceeds above the mortgage amount go to the seller — borrower. What is problematical here is the ready ability to actually sell the property. A soft market, high interest rates or a divorce between the borrowers are just a few of the factors which could impede a sale. Nevertheless, it **is** something to consider — if you want to wait.

Still, as lenders recognize, the various alternatives presented may not salvage the borrower's position. Then, consideration of foreclosure must be addressed. If the property is worth at least the

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Response Ad In The Mail And Wait For The Orders To Roll In.
Direct marketer Robert Collier had the best answer for this one — and what he said was absolutely true. "Put an ad in an envelope just as it stands, and it will not pull one-fourth as well as when split up into a letter, circular and order form."

Enough said.

41) The Most Important Element Of A Catalog Is The Copy.
Just when you think it's settled that "words words words" do your principal selling, along comes a major exception! The three principal elements of a catalog — photography, design, copy — are important in exactly that order. (But copy is **still** very important — especially on your order form!)

42) The Most Effective Offer My Company Can Make Is One With An Ironclad Money-Back Guarantee.
That is indeed an attractive offer, but here's one that's even better. A **free home trial** offer.

True, with a free trial offer you'll have 10-15 percent "returns." On the other hand, this offer will likely **double your response!**

43) The Most Important Element Of A Direct Mail Package Is The Brochure.
This is probably a special case of "the most important thing in a direct response ad is the photograph" — and it's equally wrong. In virtually every case, the **direct mail letter** is the most important element in the package — followed by the order form, the outside envelope and the brochure. In that order.

Always use a letter in your mailings. **Always** include a separate order form. Then, if budget permits and you think it will help, add a brochure to your mailing.

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amount of the mortgage, the lender can expect the full obligation to be satisfied. But even under the best of circumstances, foreclosures are time consuming, often expensive, and generally considered to be unpleasant, although competent counsel can diminsh these concerns.

Should both lender and borrower wish to avoid the foreclosure action, an alternative is the giving of a deed in lieu of foreclosure from the owner to the lender. In essence, this dispenses with the necessity of the legal action and saves considerable expense.

There are some technical considerations in this area to be mentioned. Taking a deed in lieu of foreclosure means the lender takes title subject to whatever liens or encumbrances may have already attached to the property, such as judgments or subordinate mortgages. Therefore, a title search **and** its careful analysis with counsel is essential.

In addition, if the borrower is insolvent, taking the deed could run afoul of the Bankruptcy Act as what is called a preference. Since these are but a few of the pitfalls associated with taking the "deed in lieu," is not always the best approach. When it is employed though, it saves expense and avoids the affront of a foreclosure.

When all else fails and a foreclosure must be begun, the shock of the action may be enough to bring the borrower to his senses. Although a foreclosure need not be settled once it has been begun, the lender nevertheless may choose to accept arrears. A payment schedule stretched out over many months could then be developed. The key for the lender, however, is not to discontinue the foreclosure, but to hold it in place pending completion of arrears. If payments are not made, the foreclosure continues and the lender has lost little time. The drafting of the payment stipulation to accommodate this settlement is critical and, while enumerating the nuances of that document is too detailed to review here, the advice is to work closely with counsel skilled in this area of law.

A final thought — on its face apparently anomalous — is that ultimately, the interests of both borrower and lender are best served by a very vigorous approach to curing defaults or foreclosing. Here is why.

When a borrower executes a mortgage note and mortgage, he binds himself to be liable for any resultant deficiency. To understand this, suppose the lender takes back a mortgage for $100,000. After a few years, it's paid down to $95,000 and then goes into default. The foreclosure is instituted. As the action wends its way to conclusion over many months, interest continues to mount. The lender may have to advance money for real property taxes and insurance. Costs attendant to foreclosure are incurred for such items as court fees, referee's fees, service of process, etc., which can aggregate $500 or sometimes well over $1,000. By the time the property goes to sale, the debt due could be up to $102,000 or more.

Assume further that on the day of the foreclosure sale, the property is "worth" only $93,000. The lender's net loss is $9,000 and he can move in court to have the borrower adjudged personally liable for that $9,000 deficiency. Accordingly, the more time a lender gives a borrower, the greater is the likelihood of a deficiency for which the borrower is responsible. A casual or overly gracious approach to defaults or prosecution of foreclosure can therefore be more deleterious than helpful.

A corollary principal relates to surplus. Again using our $100,000 mortgage reduced to $95,000, it may be that by the time of the sale of the house is "worth" $115,000. With the lender's upset price at the sale of $102,000, any bids above that sum create a surplus. If an outside buyer bids on the property at $112,000, a surplus of $10,000 is created. This is then available to the **borrower,** (although judgment creditors, if any, would have a prior claim). Again, the longer the action takes, the more costs increase, thereby **decreasing** any available surplus. So. vigor, is an **aid** to the borrower.

In the final analysis, the compassionate but astute lender walks a very fine line in discharging his responsibilities. Protecting the loan and helping the borrower may not necessarily conflict. If one understands the concept, doing both may be possible.