REJECT THE POST ACCELERATION CHECK? DISPELLING THE MYTH *

** By Bruce J. Bergman

Perhaps the number one misconception in mortgage servicing is that any mortgage payment remitted after acceleration must be returned and rejected. The notion found its way to the top of the list for our presentation at the MBA's February 2005 Mortgage Servicing Convention entitled "The 20 Greatest Loan Servicing Myths"[1], and has continued as a staple at each subsequent USFN seminars as well. The number of inquiries we receive on this subject, though, confirm that this is still the source of confusion, suggesting that renewed clarification here can be helpful.

THE REAL RULE

A post-acceleration check not sufficient to reinstate the mortgage *can* be accepted. Whether a servicer *wishes* to do so, however, becomes more of a business, rather than a legal decision - which will be explained later.

BEFORE DEFAULT AND ACCELERATION

Thinking about what servicers do with late remittances before default occurs should help in better understanding how to handle payments once there is a default.

Suppose for example that the borrower's monthly mortgage payment is $1,000, due on the first of the month(let's say its January) with a typical 15 day grace period. The check isn't drawn until the 18th and not received by the servicer until the 21st. Would the servicer send the check back? Of course not. Unless the servicer is anxious to foreclose, this is just a late payment (hardly so

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unusual) and maintaining a performing loan is overwhelmingly the goal.

Assume next that no payment ever arrives during January, but $1,000 is submitted on February 17, by which time both January and February are late and $2,000 is due. (Ignore late charges for lucidity of example.) Would the servicer send back the $1,000? Again the answer is "no". The $1,000 is applied to January; February remains open and calls or letters will likely be addressed to the borrower to correct the situation.

At this moment, the borrower is in default, but no default has been declared or effectuated. Nothing "official" has happened. There is nothing a servicer can waive. We just have a slow paying borrower - no legal issues, no legal confusion.

ROLE OF THE BREACH LETTER

Because the ubiquitous Fannie/Freddie uniform instrument imposes it, for residential mortgages, most often a prerequisite to accelerating the mortgage balance is the sending of a breach notice to the borrower advising of the nature of the default and affording 30 days to cure. This commonplace requirement tends to muddy our underlying question and so addressing it first will serve to clarify.

Assume our same borrower, but this time, nothing has been received for January, February and March. On March 19 (with the grace period now passed for that month also) the servicer sends the breach letter requiring submission of $3,060 (three months of past due installments and three months of late charges) within 30 days.

What if the borrower sends $2,000 on the 27th day? Can the check be accepted, or must it be returned? The real question to ask is whether upon submission of the $2,000 the borrower's default has been cured. The answer, of course, is "no", because the remittance failed to include one monthly sum and the late charges. Therefore, as of the moment of check submission - and at

conclusion of the 30 day cure period - the borrower remains in default.

If one thinks about it, the circumstance is really the same as that usual, earlier situation where no default was declared and in February the servicer correctly applied the check to January. To emphasize the point, the borrower remains in default even when the $2,000 is accepted and retained. Accordingly, at the conclusion of the 30 days, the servicer is free to declare due the balance of the mortgage (accelerate) even though some money has been received. (And there is no need, by the way, to rebreach.)

This then leads us to the heart of the matter: monies submitted after that acceleration.

POST-ACCELERATION PAYMENTS

For ease of analysis, let's assume that the same borrower owing $1,000 per month on the mortgage is in default for January through March, ignored the breach letter entirely so that acceleration was declared in early April. At that time the arrears were $4,060 (four monthly installments and three late charges).

As a matter of in New York and most states, once a mortgage has been accelerated, a mortgage holder need not accept a reinstatement. The lender has become entitled to the full balance of the mortgage. The only exception to the rule is that the parties can make a different agreement in their contract (which is the mortgage). The Fannie/Freddie version does indeed oblige the mortgage holder to accept a reinstatement up to the moment a foreclosure judgment issues (in judicial states like New York and New Jersey) with the further condition that *all* arrears are submitted, including legal fees.

There is thus a rule here: with the common Fannie/Freddie mortgage, there can be reinstatement after acceleration and if the check is in the correct reinstatement amount the lender or servicer must accept it. It cannot be rejected. But this has nothing to do with waiver of acceleration.

It is the rule because it is what the parties agreed to.

Now we arrive at the ultimate point and the myth. Suppose after acceleration the borrower remits *less* than all the arrears. Does it have to be returned? No. (Remember, the Fannie/Freddie mortgage is silent on this point., addressing only a tender of *full* reinstatement)

When the borrower submitted less than full arrears, was the borrower not still in default? Yes. The fear which gives rise to the myth is the belief that accepting a payment after acceleration is a waiver of that acceleration - a wise concern to be sure. But here's the rule. Assuming no Fannie/Freddie mortgage form (so that full reimbursement need not be accepted), receipt and retention of a sum sufficient to reinstate *is* a waiver of acceleration. Because you don't have to take it, if you don't want it, promptly return it. Then there is no waiver.

When the remittance would not be enough to reinstate, then the acceleration cannot be waived by accepting it, so keeping the check is fine.

That said, there remain practical concerns. A borrower bent on delaying or defeating the foreclosure could claim that the reason he submitted a part of the arrears after acceleration was because he had entered into a verbal understanding with the servicer who agreed not to foreclose if that amount was sent. It is not true, but a sympathetic court might give the assertion credence under some circumstances. One way to avoid the problem is to send a letter to such borrowers advising that receipt of the check is insufficient to reinstate, its acceptance is not a waiver and is without prejudice to exercise all of the lender's rights and without prejudice to continuation of the foreclosure. This serves to enlighten the facts when litigated and help explain to a court considering an errant borrower's entreaties why there really was no waiver.

From an overall perspective there are two practical views of all this. Some servicers welcome receipt of large sums of money. (Across a broad portfolio the dollars add up when

thousands of delinquent borrowers are sending in partial payments.) They would prefer to receive these amounts and if in one or two of one hundred cases a borrower wins a waiver claim, it is a minor price to pay. Other servicers want to avoid any litigation whenever possible and so reject all sums which would not reinstate the mortgage.

It therefore becomes a matter of business judgment: take all the money and lose a case in a rare instance, or avoid the concern altogether by rejecting all the post acceleration checks. But it remains a myth that a check after acceleration insufficient to cure all arrears cannot be retained. As a matter of law, it can be. As a matter of business, you decide.