



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

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Subject: Date of Default in Rolling Default Situations on Multifamily Mortgage Insurance Claims

MEMORANDUM FOR: John L. Stahl, Director, Multifamily Financial Operations Division, HWAFFR

FROM: John J. Daly, Associate General Counsel, Office of Insured Housing, CI

SUBJECT: Date of Default in Rolling Default Situations on Multifamily Mortgage Insurance Claims

This memorandum responds to your November 24, 2003 request for legal advice about how to determine the default date on claims involving “rolling defaults.”

Background

A disagreement has arisen in recent months between the Multifamily Claims Branch (MCB) and various mortgagees regarding the date of default in “rolling default” situations. MCB has taken the position that subsequent payments by a mortgagor that do not cover all outstanding payments on the loan would not be sufficient to change the default date. Since the default date does not change, MCB asserts that, if a mortgagee fails to meet the deadline for filing its election to assign, MCB can curtail interest on the claim. The Mortgage Bankers Association has formed a working group of loan servicers and has asked for a meeting with the Office of Housing to discuss the issue.

In a typical “rolling default” claim, a mortgagor fails to make a monthly loan payment, fails to make a second monthly payment, and then makes a subsequent payment that is sufficient to cover the first missed payment but not the second missed payment. For example:

- | | |
|---------|---|
| June 1 | Mortgagor misses a loan payment. |
| July 1 | Mortgagor misses a loan payment. |
| July 15 | Mortgagor makes subsequent payment sufficient to cover the June payment but not sufficient to cover the July payment. |

MCB has taken the position that, unless the subsequent payment on July 15 is sufficient to cover all overdue payments, the default date does not change. Since the subsequent payment on July 15 is not sufficient to cover both the June 1 and the July 1 payments, MCB treats the default date as June 1.

On the other hand, mortgagees take the position that the subsequent payment may be applied to the first missed payment so the default date will “roll” forward to the date of the next missed payment. In the example above, the mortgagees treat the default date as July 1. The determination of the default date is important because mortgagees must file their election to assign the loan to HUD within 75 days after the default date.

Analysis

The rolling default issue is covered in HUD’s regulations at 24 CFR 207.255(d) and in HUD Handbook 4350.4, Insured Multifamily Mortgage Servicing and Field Office Remote Monitoring, CHG 7, issued June 26, 1996. We will examine the regulation and the Handbook guidance.

Regulation

The date of default for the purposes of multifamily mortgage insurance is defined in 24 CFR 207.255(d) as follows:

“(d) For the purposes of this section the date of default shall be considered as:

- (1) The date of the first uncorrected failure to perform a covenant or obligation; or
- (2) The date of the first failure to make a monthly payment which subsequent payments by the mortgagor are insufficient to cover when applied to the overdue monthly payments in the order in which they became due.”

The regulation specifically provides that the mortgagor may make subsequent payments and that those may be applied to the overdue monthly payments “in the order in which they became due.” This phrase implies that a subsequent payment may be less than the total amount of the overdue payments. We think this language permits a subsequent payment to be applied to the first overdue payment, which then will “roll” the default date forward to the date of the next overdue payment.

The regulation does not require that the subsequent payment cover all overdue monthly payments as MCB has suggested. MCB’s interpretation would not make sense for two reasons. First, if the subsequent payment covered all overdue payments, there no longer would be a default (i.e., no default date) which would make the definition of “date of default” meaningless. Second, the regulation specifically requires that the subsequent payment be applied to overdue payments in a particular order, the order in which they became due. The language in the regulation would be superfluous if, as MCB suggests, the subsequent payment must cover all overdue payments. There would be no reason in that case to apply the subsequent payment in any particular order.

MCB may be confusing the concept of “curing a default” and reinstating the loan with the concept set forth in Section 207.255(d)(2) of changing the “default date.” To cure a “default,” the mortgagor must make a subsequent payment that covers all overdue payments as your November 24 memorandum stated at the top of page 2. In that case, the loan would be reinstated as provided in 24 CFR 207.256a. The “rolling default” situation, however, is different from the “cure and reinstate” situation. In a rolling default, the default status continues, and only the default date changes. When the

mortgagor makes a subsequent payment that covers only a portion of the overdue amount, Section 207.255(d)(2) permits the mortgagee to apply the subsequent payment to the overdue payments in the order they became due, and the new default date will be the date of the oldest remaining overdue payment which a subsequent payment is not sufficient to cover.

Handbook 4350.4

OGC's interpretation of the regulation is supported by very specific language in Change 7 to HUD Handbook 4350.4, issued June 26, 1996. Section 2-44(d) of the Handbook provides:

“The date of default is the due date of the first unpaid payment when payments are applied in the order in which they come due. For example, if an owner did not make the payment due June 1 by July 1, the mortgage is in default as of June 1. If the payment is not made on or before July 1, the mortgagee's entitlement to receive insurance benefits vests on July 2 (the day following the expiration date of the 30-day grace period which begins after the payment due date). If the owner did not make the June 1 and July 1 payments but did make one monthly payment on August 15, the mortgagee could apply the payment received on August 15 to the June 1 payment if the mortgagee had not made its election to assign the mortgage to HUD.”

(1) In the preceding example, if the mortgagee applied the funds received on August 15 to the payment due June 1, **July 1 would be the new default date for purposes of calculating insurance benefits.** In this case the mortgagee must comply with all procedural and filing deadlines that apply to a new default date. In this example, the mortgagee must submit a notice of default using Form HUD-92426 no later than August 30 regarding the delinquent July 1 payment and must make the assignment election by September 14 unless an extension of the latter deadline is requested from and granted by HUD.” [emphasis added]

The Handbook example specifically allows a mortgagee to apply a subsequent payment (received on August 15) to the first overdue payment (the June 1 payment) even though the subsequent payment is not sufficient to cover all the overdue payments. The application of the subsequent payment rolls the default date forward to the new default date (July 1) and also rolls forward the deadline for filing the election to assign to 75 days after the new default date (September 14). As the Handbook notes, the mortgagee must comply with all procedural and filing deadlines “that apply to the new default date.”

In our discussions with MCB on this issue, your staff asked why HUD as a policy matter would allow a mortgagee to accept a subsequent payment and roll the default date forward when the subsequent payment did not cover all the overdue payments. Handbook Section 2-44(d)(2) provides one possible answer by stating:

“The Department encourages mortgagees to choose the option to allow a mortgagor to make up a payment that is past due to allow time to work with a mortgagor.”

In other words, by giving a mortgagee time to work with a mortgagor, HUD avoids an immediate mortgage insurance claim. Consequently, there is a policy reason for permitting a rolling default.

MCB staff has suggested that the Handbook is for HUD internal use only and should not be relied upon by mortgagees. We believe that the Handbook is intended for use by mortgagees and sets forth HUD's own interpretations of regulatory requirements. The transmittal page for Change 7 states that it is for the special attention of "All HUD-Approved Mortgagees" and provides that "This transmits additional guidance for filing Notices of Default, Form HUD-92426, and describes suggested and required actions in the event of a 'rolling default.'" The Foreword to the Handbook states that "[t]his handbook outlines what HUD believes to be procedures that mortgagees should use as servicing practices" and that "this handbook provides lenders who hold or service these mortgages a convenient reference for existing procedures and requirements of the Department." Two mortgagees that recently have had interest curtailed on their claims have cited the Handbook to us as the basis for their appeals that the curtailments should be reversed.

Conclusion

Based on our review of the applicable regulations and the guidance provided in HUD Handbook 4350.4, we think that a mortgagee may apply a subsequent payment to the first missed payment, and the default date may roll forward to the date of the next missed payment that the subsequent payment is insufficient to cover, provided that the mortgagee has not yet made its election to assign the mortgage to HUD. It is not necessary that the subsequent payment be sufficient to cover all the overdue payments.

The example set forth in Section 2-44(d)(1) appears very similar to the fact pattern in recent rolling default claims in which MCB has curtailed interest. In those claims, mortgagors made subsequent payments that were sufficient to cover one, but not all, overdue payments. MCB refused to change the default date or the deadline for the election to assign so interest was curtailed on the claims. Based on our interpretation of the regulation and the Handbook, MCB should have acknowledged a new default date and a new deadline for the election to assign in those cases. If MCB curtailed interest based solely on its determination that a subsequent payment could not roll forward the default date, the curtailment of interest by MCB would not be correct.

We are available to review individual claims with your staff to determine whether a mortgagee has satisfied all applicable procedural and filing deadlines and whether interest should have been curtailed on those claims. Please contact Michael Collotta at ext. 5249 if you have any questions or desire further assistance.

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