



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

Internal/External  
Topic: Multifamily

OFFICE OF GENERAL COUNSEL

July 19, 2012

MEMORANDUM FOR: Betty Belin, Chief Multifamily Claims Branch, HWAFCRC  
FROM: Millicent B. Potts, Associate General Counsel for Insured Housing, CAHA  
SUBJECT: Mortgage Covenant Default Date

This memorandum responds to your request for advice about the method for arriving at the date of default when there has been a mortgage covenant default. This memorandum supersedes the May 4, 2001 memorandum from John Daly, Associate General Counsel, Insured Housing, to Gary G. Zimmerman, Chief, Multifamily Claims Branch and Beverly J. Miller, Director, Office of Portfolio Management.

#### Statutory Provision

Section 207(g) of the National Housing Act (12 U.S.C. 1713(g)) ("Section 207(g)") provides the statutory authority for payment of a claim for mortgage insurance benefits. That section states, in part, that "[T]he failure of the mortgagor to make any payment due under or provided to be paid by the terms of a mortgage insured under this section shall be considered a default under such mortgage," and if the default continues for thirty days, the mortgagee becomes eligible for FHA insurance benefits. Pursuant to this provision, a mortgagee becomes eligible for mortgage insurance benefits only when there is a monetary default that continues for at least 30 days. The statute does not discuss, nor preclude, the administrative determination of a covenant default, which is discussed in HUD regulations.

#### Regulatory Provisions

The regulations at 24 CFR 207.255<sup>1</sup> recognize both monetary and covenant defaults and contain different criteria for each for purposes of calculating a mortgage insurance claim, based upon the date of the firm commitment and the applicable FHA insurance program. For multifamily loans for which HUD issued a firm commitment before September 1, 2011 and all multifamily loans insured under Section 232 or Section 242 of the National Housing Act (regardless of the date of the firm commitment), the applicable regulations are found at 24 CFR 207.255(b). For multifamily loans (other than loans insured under Section 232 or Section 242 of

<sup>1</sup> As revised, 76 Fed. Reg. 24363 at 24370 (May 2, 2011), effective September 1, 2011.

the National Housing Act) for which HUD issued a firm commitment on or after September 1, 2011, the applicable regulations are found at 24 CFR 207.255(a).<sup>2</sup>

The regulations at 24 CFR 207.255(a)(1) provide that except for the provisions of 24 CFR 207.255(b), a default shall be:

- (i) Failure of the mortgagor to make any payment due under the mortgage (also referred to as a “Monetary Event of Default” in certain mortgage security instruments); or
- (ii) A material violation of any other covenant under the provisions of the mortgage, if because of such violation, the mortgagee has accelerated the debt, subject to any necessary HUD approval (also referred to as a “Covenant Event of Default” in certain mortgage security instruments).

Section 207.255(a)(4) states, in part, that “the date of default shall be: ... (ii) [t]he date of the first uncorrected violation of a covenant or obligation for which the mortgagee has accelerated the debt.” (emphasis added)

The regulations at 24 CFR 207.255(b)(1) provide that the default shall be:

- (i) Failure of the mortgagor to make any payment due under the mortgage; or
- (ii) Failure to perform any other covenant under the provisions of the mortgage, if the mortgagee, because of such failure, has accelerated the debt. (emphasis added)

Section 207.255(b)(4) states, in part, that “the date of default shall be considered as: (i) [t] he date of the first uncorrected failure to perform a covenant or obligation; ...” Since the definition of default in Section 207.255(b)(1)(ii) requires acceleration of the loan in order for failure to perform a covenant to constitute a default, acceleration is implicit in “default” in Section 207.255(b)(4).

Consistent with the statute, the regulations state that, if a default (as defined in Sections 207.255(a)(1) or (a)(2) and 207.255(b), respectively) continues for a period of 30 days, the mortgagee shall be entitled to receive FHA insurance benefits. *See* 24 CFR §§ 207.255(a)(3) and 207.255(b)(3).

## Legal Application

### Payment of Claim Based on Covenant Default

A covenant default must be converted to a monetary default in order to for the mortgagee to

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<sup>2</sup> The exception noted in this provision is not likely to be applicable because it requires that the mortgagor demonstrate that he had a reasonable expectation that his loan would close under the regulations in effect prior to September 1, 2011. *See* 24 CFR 207.255(a)(5).

become entitled to mortgage insurance benefits.

a. Acceleration Letter

To effectuate this conversion, when a HUD official or a mortgagee becomes aware of a covenant violation, he or she must first provide the mortgagor with notice and an opportunity to cure, consistent with provisions of the HUD regulatory agreement or mortgage. If the mortgagor fails to cure the violation within the timeframe provided in the notice of violation, HUD may request the mortgagee to accelerate the loan or the mortgagee may do so on its own initiative. If done on its own initiative, the mortgagee must also give notice of the covenant violation to the Commissioner (pursuant to 24 CFR 207.256(b)). The mortgagee is responsible for drafting and sending the notice of acceleration letter to the mortgagor. Mortgagees should be advised to include language similar to the following in the letter:

If the default is pursuant to 24 CFR §207.255(a):

The declaration of default and acceleration of the debt constitutes a default as provided in 24 CFR Section 207.255(a)(1)(ii) of the regulations. Accordingly, the outstanding balance of principal and interest on this loan is hereby declared due and payable, in its entirety, on [insert date], in accordance with the terms of the mortgage and the applicable federal regulations.

If the default is pursuant to 24 CFR §207.255(b):

The declaration of default and acceleration of the debt constitutes a default as provided in 24 CFR Section 207.255(b)(1)(ii) of the regulations. Accordingly, the outstanding balance of principal and interest on this loan is hereby declared due and payable, in its entirety, on [insert date], in accordance with the terms of the mortgage and the applicable federal regulations.

b. Date of Default

If payment in full is not received by the mortgagee by the due date stated in the notice of acceleration letter, the date of default will be the day after the stated due date. If the notice of acceleration does not state a specific due date, but contains language to the effect that the outstanding balance of principal and interest on the loan is declared immediately due and payable, the date of default will be the day after the date of the notice of acceleration letter, provided that payment in full is not made. We encourage the Office of Housing and mortgagees to state a specific payment due date within the acceleration letter, to avoid ambiguity.

c. Interest and Eligibility for Benefits

Interest on the mortgage insurance claim is paid from the date of default, pursuant to 24 CFR 207.259(b)(1)(iii). The mortgagee becomes eligible for insurance benefits on the 31<sup>st</sup> day after the date of default. See 24 CFR §§ 207.255(a)(3) and 207.255(b)(3).

Mortgagees should be encouraged not to delay loan acceleration after sending notice to the mortgagor of the covenant default or after being instructed by the Commissioner to accelerate payment. For loans that closed after September 1, 2011, failure of the mortgagee “to comply promptly with the Commissioner’s request to accelerate payment pursuant to §207.257” may result in a deduction from the amount paid under the insurance claim, as set forth in 24 CFR 207.259(b)(2)(vi) and (b)(2)(vii).

Please contact Stephanie Chaharbaghi at ext. 5231 if you have any questions or desire further assistance.