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SUBJECT: UNDERSTANDING THE RIGHTS OF SOLDIERS AND SAILORS TO MORTGAGE LOAN RELIEF DURING OUR WAR ON TERRORISM

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In the aftermath of the horrific Attack on America of September 11, 2001, as many as 50,000 National Guardsmen and military reservists activated by the President of the United States to wage our War on Terrorism may be entitled to extraordinary relief from mortgage obligations and other civil claims during periods of active duty.

The cornerstone of these rights is the Soldiers and Sailors Civil Relief Act of 1940, which Congress enacted to protect the individual rights of the millions of servicemen activated for World War II and, in the national interest, enable them to devote their entire energies to the defense of their country without worry about financial burdens at home. Its protections have been available to service members continuously ever since, including those serving in the Gulf War of 1991, and will extend to those service members now called up by the President. This broad reaching federal law imposes strict limitations on interest and other fees and charges that may be imposed by creditors in connection with mortgage and other indebtedness incurred by service members prior to a period of active duty, and, in most cases, imposes a moratorium on civil actions against service members, including foreclosures, evictions, repossessions, involuntary bankruptcies, and executions of judgments, attachments and garnishments. Additionally, government-sponsored secondary market makers, Fannie Mae and Freddie Mac, and the federal Department of Housing and Urban Development (HUD) and Department of Veterans Affairs (VA) (collectively the "Housing Agencies") have published regulations governing the lenders' and servicers' duties under this federal law when making and servicing mortgage loans purchased, insured, or guaranteed by one of those housing agencies. This article briefly examines the relief from enforcement of home mortgage loan obligations to which persons in any branch of the military service are entitled under SASCRA when called to active duty and the compliance duties of mortgage lenders and servicers under related regulations of the Housing Agencies.

Applicability of SASCRA Relief

All members of the United States Armed Forces, including the Army, Navy, Marine Corps, Air Force, Coast Guard (and officers of the Public Health Service when detailed for duty to the Army or Navy) are covered by SASCRA when on active duty with any of these branches of military service. "Active duty" for this purpose includes not only the period of military service commencing with the date of entering active service and ending on the date of release from active service (or death while in active service), but also periods of training or education under governmental supervision preliminary to induction into military service and any periods of absence from duty on account of sickness, leave, or

other lawful cause. However, protections under SASCRA against enforcement of obligations or liabilities of persons inducted into military service may commence as early as the date ordered to active duty and, in some cases, may extend for periods of from 60 days to six months after the date that active duty ends. These protections also may extend to persons not in military service who are sureties, guarantors, endorsers, or accommodation makers of an obligation or liability of a service member when enforcement of the obligation or liability is stayed or suspended under SASCRA.

Generally, relief from civil liabilities under SASCRA is limited to obligations and liabilities incurred by a service member prior to induction into military service or, in the case of members of the National Guard and reservists, prior to commencement of a period of active duty. But relief also may be granted for obligations and liabilities incurred by a service member during a period of active duty if an intervening break from active duty occurs before reactivation.

“Material Affect” Condition

An extraordinary scope of relief from mortgage obligations, credit card accounts, and other indebtedness (other than student loans) is available to eligible service members under SASCRA. Not only are interest rates, including related charges and fees, capped at 6% per year, but also enforcement of civil liabilities in most cases is suspended unless a court determines that the ability of the service member to pay or otherwise perform under the obligation is not *materially affected* by reason of his or her military service. This so-called “material affect” condition under SASCRA essentially requires a showing only that the service member will earn less income while on active duty than prior to activation. Although the availability of specific relief under SASCRA discussed in this article is subject in any case to this “material affect” condition, it is doubtful that many mortgage lenders or servicers during the current period of patriotic fervor will choose to challenge the entitlement of National Guardsmen and reservists activated by the President to the benefits and protections of SASCRA. None of the Housing Agencies in fact require that a servicer assess whether the “material affect” condition is satisfied before reducing the mortgage interest rate, so long as the service member is otherwise eligible for that benefit under SASCRA. Even in absence of a service member’s showing of “material affect”, furthermore, a court of proper jurisdiction is given broad equitable powers under the statute and may make a determination to reduce an interest rate or stay an action as the court may deem *just*.

Maximum 6% Interest Rate Benefit

Interest on home mortgage loans made to service members prior to their entry into active service, if greater than six percent, must be reduced to a rate not exceeding six percent per year for the period of active duty under SASCRA. “Interest” for this purpose includes, in addition to the contract interest rate, all related service and other charges, including renewal fees and late charges. Mortgage insurance and escrow reserves for property insurance, taxes, and assessments are unaffected by this limitation and must be paid by the service member in accordance with contractual terms.

Remarkably, the interest differential between the contract interest rate and the statutory six percent rate cap is not merely deferred under SASCRA, but is forgiven as a matter of law. While holders of affected mortgage loans suffer the resulting interest loss, Fannie Mae and Freddie Mac seller-servicers and Ginnie Mae issuers are entitled during this period to their full servicing fees and to reimbursement for interest shortfalls when interest is advanced by them under applicable guidelines of these Housing Agencies. VA alone among the Housing Agencies disclaims liability for the inter-

est loss, construing its liability under a VA guaranty as limited to the legal liability of the veteran borrower when a loan holder files a claim on the guaranty.

Reduction in the mortgage interest rate to six percent is required regardless of whether the mortgage status at the time is *current*, *prepaid*, *delinquent*, or *in foreclosure*. However, payments that are delinquent when the service member enters active duty may continue to bear interest at the contract interest rate then in effect, and any prepaid installments that have already been applied at that time are not required to be reapplied at the lower rate.

Protections from Foreclosure and Eviction

Foreclosures under home mortgage loans that were made to service members prior to a period of active duty are not valid if commenced during a period of military service, or within three months thereafter, unless made upon an order previously granted by a court of proper jurisdiction after its consideration of the rights and protections afforded the service member under SASCRA.

In any court proceeding to enforce such a home mortgage loan against a service member for non-payment or other breach of terms occurring prior to or during a period of military service, the court may, after conducting a hearing and on its own motion, stay (i.e., suspend or hold in abeyance) the foreclosure proceedings during the service member's period of military service or, in its discretion, make such other disposition of the case as may be equitable to conserve the interests of all parties. If an application for relief from foreclosure is made by a service member while on active duty, furthermore, the court must stay the foreclosure proceedings, unless on hearing the court finds that the service member's ability to comply with the mortgage terms is not "materially affected" by reason of his or her military service.

Courts are given broad authority under SASCRA in these cases to make an equitable disposition of foreclosure proceedings. A court in a proper case may, for example, stay the enforcement of the home mortgage both for the remaining period of active military service and, thereafter, for an extended period equal to the remaining term of the mortgage plus a number of months equal to the period of active military service, subject to the service member's ability and agreement to then repay the outstanding balance of the loan principal and accrued interest over that extended period in equal monthly, or other periodic, installments at the contract rate of interest and upon such other terms as the court thinks just. Conversely, after staying the foreclosure, the court nevertheless may order the foreclosure if in its opinion foreclosure would not cause an undue hardship to the service member's dependents, and any sum of money as the court may deem just, based upon the report of three disinterested appraisers appointed by the court to appraise the secured property, is paid to the service member or his or her dependents as a condition of foreclosure. Furthermore, lenders renting owned real estate properties (REO) after foreclosures should be aware that under SASCRA no eviction or distress action may be prosecuted against a service member when the premises are primarily occupied for dwelling purposes by the spouse, children, or other dependent of the service member while on active duty and the rent does not exceed \$1,200 per month. The court in that case may stay the proceedings for not longer than three months or make such other order as may be just.

Any attempt by a mortgage lender or its counsel to evade these SASCRA protections and knowingly conduct a foreclosure, forced sale, eviction, or seizure of property without such an order and supervision of a court of proper jurisdiction is subject to criminal sanctions, including imprisonment not to exceed one year and/or fines not to exceed \$1,000.

Protections Against Other Legal Proceedings

Lawsuits by mortgage lenders against service members, such as actions to collect a deficiency on a note obligation, enforce performance with contractual terms, or foreclose on a security interest other than a real estate lien, are subject to these same broad powers of courts under SASCRA to suspend civil actions and grant equitable relief to service members during active duty as the court may deem just.

A service member at any stage of such a legal proceeding occurring during a period of active service, or within 60 days thereafter, is entitled on application to the court to have the proceedings stayed or to have execution of the any judgment or order entered against the service member stayed and any attachment or garnishment of property held by another stayed or vacated (unless the court finds on hearing that the ability of the service member to defend the action is not materially affected by reason of his or her military service). The court in that case may order the stay for a combined period of military service plus three months thereafter. If the action is to enforce the service member's compliance with the terms of any contract, no fine or penalty under the contract may accrue against the service member during the period of the stay.

Service members also are protected under SASCRA against default judgments in civil suits that otherwise might be taken against them during periods of active duty. In any court action in which there is a default in the appearance of the defendant, the plaintiff before entering judgment must first file an affidavit with the court setting forth facts showing that the defendant is not in military service. Such an affidavit must be made under penalty of perjury punishable by imprisonment not to exceed one year and/or a fine not exceeding \$1,000. If the plaintiff fails to establish factually by affidavit that the defendant is not in military service, no judgment may be entered until, on application of plaintiff, the court appoints an attorney to represent the defendant and protect his interests. A bond also may be required of the plaintiff to indemnify the defendant if it is subsequently established that the defendant is in military service and is entitled to set aside any judgment entered in the suit. Even when a service member appears and defends a suit in which a judgment is entered against the service member during a period of military service, or within 30 days thereafter, the court rendering the judgment may open the judgment and let the service member in to defend if, after timely application made by the service member within 90 days after release from service, it appears to the court that the service member was prejudiced in making his defense to the suit by reason of his military service and has a meritorious defense to assert. Vacating, setting aside, or reversing any judgment entered against a service member under this provision, however, does not impair any right or title acquired by a bona fide purchaser for value in reliance on the judgment.

Any statute of limitations for bringing or enforcing any action in any court or governmental proceeding against a service member is tolled (i.e., temporarily suspended) under SASCRA during a period of military service, whether the cause of action accrued prior to or during the period of active duty. Similarly, any statutory period of redemption given a homeowner to reclaim title to real property after foreclosure is tolled during a period of military service, even if the foreclosure takes place before the commencement of a period of active duty if the redemption period has not expired by the date the service member receives orders to report to active duty.

Certain Duties of Mortgage Servicers

Although not required under guidelines of the Housing Agencies to assess or challenge the eligibility of any service member for the reduced rate benefit based upon the “material affect” condition, mortgage servicers still must use due diligence to otherwise determine the eligibility of any service member for the benefit. To that end, servicers must determine that (i) the mortgage in question is the contractual obligation of the service member as borrower, co-borrower, or as an approved obligee under a written assumption agreement; and (ii) the note or assumption agreement secured by the mortgage was executed prior to the reporting date of the service member’s active federal duty as shown by his or her official military orders. It is unnecessary under these guidelines to enter into a formal loan modification agreement to give effect to the reduced rate during a period of active duty unless an agreed rate reduction or a forbearance of any kind will apply for any period after the service member is no longer on active duty.

To give effect to these requirements, servicers under Fannie Mae and Freddie Mac guidelines are instructed to make the reduced six percent rate effective with the first payment due after the service member enters active duty (thereby assuring that the service member receives the benefit of the lower rate for any part of the preceding month in which the service member was on active duty, since interest is paid in arrears). Similarly, to assure proper credit at the lower rate for any part of the service member’s last month of active duty, servicers are to reinstate the contract interest rate effective as of the second payment due after the service member is released from active duty. FHA servicers similarly are permitted to prorate interest for the first and last months of active duty on a per diem basis, or choose to permit the lower interest rate for the entire month. Servicers must calculate the service member’s monthly payment of principal and interest in each case based upon an amortization of the rate then in effect over the then remaining term of the loan in substantially equal, consecutive monthly payments. When reinstating the interest rate to contract terms after the service member’s completion of active duty, the rate is restored to the original contract rate in the case of a fixed-rate mortgage or, in the case of an adjustable-rate mortgage, adjusted to the rate that otherwise would have been in effect at the last interest adjustment date during the rate-cap period (based upon the index and margin then in effect and other contract terms).

Although service members generally are thought to have a duty to notify mortgage loan holders or servicers of their eligibility for a reduction of their interest rate, SASCRA does not in fact impose any such affirmative duty as a condition of receiving the rate-reduction benefit. Servicers, before refusing an installment payment as insufficient in any case, are expected to investigate payments received in reduced amounts that approximate the payment that would be due at a six percent rate to determine if the borrowers tendering such payments are in fact service members entitled to a rate reduction under SASCRA. Even if not learning of a service member’s eligibility for the reduced rate until as late as 60 days after a period of active duty is completed, servicers under Fannie Mae and Freddie Mac guidelines are instructed to fully apply the benefit of the reduced six percent rate retroactively. When notified, or otherwise learning, that an eligible service member has been called to active duty, the servicer must calculate and give effect to the reduced rate in accordance with these guidelines, inform the service member of the adjusted amount due each month, provide adjusted coupons or monthly billings in that reduced amount, and ensure that payments received during a period of active duty at the reduced amount are not refused as insufficient or reported as delinquent to a consumer credit reporting agency.

Beyond the rights and protections afforded service members under SASCRA, mortgage servicers also should be mindful that the Housing Agencies generally encourage granting all affected borrowers, including service members, special forbearance from the strict enforcement of mortgage obliga-

tions in cases of hardship. Affected victims of the tragic events of September 11, 2001, and service members experiencing the hardship of employment disruption, family separations, and financial burdens resulting from special military actions, such as Operation Enduring Freedom, should be given special consideration under these guidelines. Servicers are given latitude when considering cases of hardship to modify loan terms to prevent foreclosures and help service members and other borrowers retain and pay for their homes. Special forbearance options to service members, for example, could include the deferral by written agreement of all principal payments for the period of military service plus three months, conditioned on the service member's resumption of monthly payments of principal and interest thereafter in amounts sufficient to fully amortize the mortgage debt over the remaining loan term. Moreover, servicers in these circumstances should investigate the applicability of any state statute that may afford service members even greater rights and protections than available to them under SASCRA, observe any special forbearance regulations of the Housing Agencies for affected victims of the tragic events of September 11, 2001, including the 90-day moratoriums declared on the foreclosure of FHA-insured and VA-guaranteed loans, and otherwise follow the loss mitigation guidelines of the Housing Agencies applicable to natural disasters, such as earthquakes and hurricanes.

Further due diligence, notice, and record keeping requirements of servicers under guidelines of the Housing Agencies may be found at Section 203.01, Part I, Fannie Mae: *Single Family/Servicing Guide*; Section 82.1 of Freddie Mac's *Single Family Seller/Servicer Guide*; HUD's ML 2001-22, dated 09-24-01, VA's Circular 26-01-10, dated 09/26/01, and Ginnie Mae's Memorandum 01-25, dated 10-03-01. The Soldiers and Sailors Civil Relief Act of 1940 is codified at 50 App. U.S.C. §§ 501, *et seq.*

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