

LOSS- MITIGATION for VA LOANS: BACKGROUND RESEARCH for ADVOCATES and LEGAL PROFESSIONALS

VA Lender Forbearance Obligations

38 CFR 36.4301 defines Special Forbearance as: “a written agreement executed by and between the holder and the borrower where the holder agrees to suspend all payments or accept reduced payments for one or more months, on a loan 61 or more calendar days delinquent, and the borrower agrees to pay the total delinquency at the end of the specified period or enter into a repayment plan.” This guide will examine whether VA Mortgagees are legally obligated to offer and/or grant Special Forbearance to veteran borrowers prior to initiating foreclosure proceedings. This guide is intended for use by legal professionals and veteran advocates. **This analysis is generally applicable to all of the VA’s recommended loss-mitigation techniques.**

Veterans Affairs (VA) administers the Loan Guarantee Program pursuant to 38 U.S.C. § 3710, and it has promulgated regulations governing the operation of the program in accordance with the Veterans’ Housing Benefits Act of 1978. 38 C.F.R. § 36.4200 *et seq.*

The VA regulations state that failure to comply with such regulations will result in loss of the guarantee. 38 CFR § 36.4286. However, the regulations do not mandate that servicers grant forbearance to veteran borrowers. Rather, the regulations state, “terms of repayment of any loan may, by written agreement between the holder and debtor(s), be extended in the event of default, to avoid imminent default. . . .” 38 CFR § 36.4279 (emphasis added). The voluntary nature of particular loss-mitigation practices by VA servicers is further revealed by the fact that the VA has implemented an incentive program for successful avoidance of foreclosure by mortgagees utilizing the VA’s recommended mitigation techniques, including Special Forbearance. 38 C.F.R. § 36.4319. Indeed, the only relevant mandate in the VA regulations regarding loss mitigation practices is one which requires that servicers make a “reasonable effort to establish . . . a realistic and mutually satisfactory arrangement for curing the default.” 38 CFR § 36.4278.

The VA has expressly laid out the loss-mitigation techniques it considers to be reasonable in the VA Servicer Guide, a non-codified set of guidelines for Loan Guarantee Lenders. *See* VA Servicer Guide, Version 1.2:

http://www.benefits.va.gov/homeloans/docs/va_servicer_guide.pdf. While the VA Servicer Guide does mandate that servicers work to bring a default current by considering Special Forbearance, servicers are not required to grant Special Forbearance. *Id.* at 76. Failure to comply with the VA servicer guide may result in loss of the VA guarantee for the lender.

While non-codified federal agency guides usually do not carry the force of law, several courts have held that failure to operate according to an agency guide when dealing with federally backed loans constitutes a breach of good faith and fair dealing under the unclean hands doctrine. First Natl. Mortg. Assn. v. Lecrone, 1985 U.S. Dist. LEXIS 23468 at *6; *See e.g. Associated E. Mortgage Co. v. Young*, 394 A.2d 899 (N.J. Super. Ct. Ch. Div. 1978); Heritage Bank, N.A. v. Ruh, 465 A.2d 547 (N.J. Super. Ct. Ch. Div. 1983); Bankers Life Co. v. Denton, No. 3-83-0275 slip op. (Ill. C.A. Third Dist., Dec. 19, 1983); Gov’t Nat’l Mortgage Ass’n v. Screen, 379 N.Y.S.2d 327 (Sup. Ct. 1976); Fed’l Nat’l Mortgage Ass’n v. Ricks, 372 N.Y.S.2d 485 (Sup. Ct. 1975). This holding does not, however, create a private right of action for the veteran against the

mortgagee. *See, e.g., Krell v. Nat'l Mortgage Corp.*, 448 S.E.2d 248, 249 (Ga. Ct. App. 1994) (Defaulting FHA mortgagor had no private right of action to pursue under the NHA); *Prudential Ins. Co. of Am. v. Jackson*, 637 A.2d 573, 576 (N.J. Super. Ct. App. Div. 1994) (No private cause of action is derived from the provisions of the HUD regulations concerning foreclosure avoidance); *Perry v. Hous. Auth.*, 664 F.2d 1210, 1215-17 (4th Cir. 1981) (Private right of action cannot be implied from the NHA); *Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 360 (5th Cir. 1977) (concluding that because the NHA and its accompanying regulations do not provide for a private right of action, the HUD Handbook distributed by the Department to mortgagees as a reference guide similarly could not support a private right of action); *M.B. Guran Co. v. City of Akron*, 546 F.2d 201, 204 (6th Cir. 1976); *see also In re Miller*, 124 Fed. App'x. 152, 154-56 (4th Cir. 2005) (unpublished) (No private right of action arises from violation of NHA loss mitigation provisions). Rather, the unclean hands doctrine may only be used as a defense in a foreclosure proceeding. Under this defense, the court may rule in equity that the unclean hands doctrine bars a ruling in favor of the mortgagee where that mortgagee has failed to reasonably operate in accordance with established federal guidelines.

Thus, while mortgagees are required by statute to make a reasonable effort to realistically and mutually cure a default, there is no statute mandating that Special Forbearance, specifically, be considered or granted. Consideration of Special Forbearance is mandated by the VA Servicer Guide, but as that guide is not codified, it does not have the weight of law. Equity courts have provided some relief through the unclean hands doctrine when a mortgagee fails to reasonably abide by a relevant agency guide, but the majority of jurisdictions have not weighed in on this issue. In no case is the mortgagee required to grant a Special Forbearance categorically.

It should be noted that most VA servicers consider special forbearance, and all other loss-mitigation techniques recommended by the VA, in all foreclosure cases because of the VA incentive program. Failure to do so results in loss of capital on the part of that servicer. Therefore, the majority of Special Forbearance issues can be resolved by notifying the lender of the VA's incentive program and then formally requesting Special Forbearance consideration.

For help with any of these issues it is recommended that you contact a VA loan service officer at **(877) 827-3702**.