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MORTGAGE AND NOTE IN DEFAULT:

A PRIMER ON LATE FEES AND DEFAULT INTEREST

Lenders and borrowers alike are increasingly faced with a mortgage and related promissory note in default and the need to calculate the balance due in a payoff situation. The payoff could be required in connection with a voluntary conveyance of the property to a third party or upon a mortgage foreclosure.

Late Charges

A late charge is imposed if a borrower does not make a scheduled payment on time. Most promissory notes contain a provision which allows the lender to charge a late fee if the borrower is late in making a payment due under the note. A typical provision is as follows:

"LATE CHARGE. If any payments are not timely made, Borrower shall also pay to Payee a late charge equal to 5% of each payment past due for 10 or more days."

Late charges should be imposed only once on the amount of the payment that was not made. Further, a lender is only entitled to late charges that accrued up until the date a note was accelerated by the bank. *Fowler & Amylene, Inc. v. First Federal Savings & Loan Association of Defuniak Springs*, 643 So.2d 30 (Fla. 1st DCA 1994). In *Fowler*, the Court considered a note which permitted a late charge of a percentage of the monthly installment not received by the bank within a prescribed time frame after the payment was due. The Court found that once the bank opted to declare the entire amount due, the late charges should not have continued to accrue on the delinquent monthly payments.

Other courts throughout the country have also found that a lender may not recover late charges once a promissory note has been accelerated and demand for payment has been made. See also, *SKW Real Estate Limited Partnership v. Gallicchio*, 49 Conn.App. 463, 716 S. A. 2d 903 (1998); *Federal Deposit Ins. Corp. v. Napert-Boyer Partnership et al.*, 40 Conn.App. 434, 443, 671 A.2d 1303 (1996) ("[A] plaintiff may not recover late charges once the note has been accelerated and demand for payment has been made on the defendants."); and *Shadhali, Inc. v. Hintlian et al.*, 41 Conn.App. 225, 229-230, 675 A.2d 3, cert. denied, 237 Conn.App. 926, 677 A.2d 948 (1996).

Courts reason that late charges should not continue to be imposed after acceleration as those installments are no longer "due" after the lender has accelerated the note and made demand for payment in full of the note. Further, if the late charges continue accruing after demand for payment in full, then such charges would in effect be considered a penalty, since the lender is already being compensated for the default by the higher (default) rate of interest being imposed. Lenders should note that if late charges are imposed multiple times and after the note has matured or has been accelerated, such late fees could potentially rise to the level of collecting usurious interest.

Should late charges be considered interest when computing total interest charges for usury purposes? Florida courts have not addressed this issue, but courts in some states have concluded that late charges are deemed additional interest. See *Thrift Funds of Baton Rouge, Inc. v. Jones*,

274 So.2d 150 (La. 1973), cert. den. 414 U.S. 820. Other courts view late charges as liquidated damages and not interest since late charges are imposed for the additional collection efforts that the lender has to expend in order to get the borrower to make the past-due payment, such as notices, bookkeeping entries, etc.

Retail Installment Contracts

Florida law permits a retail installment contract lender to impose a late fee as follows:

Section 520.37 of Florida Statutes states: "A retail installment contract may provide for payment by the buyer of a delinquency charge on each installment in default for a period not less than 10 days. Such charge may not exceed 5 percent of such installment. A retail installment contract or a revolving account may provide for the payment of reasonable attorney's fees if referred for collection to an attorney not a salaried employee of the retail seller and for the payment of court costs."

Leases and Sales Contracts

Further, landlords and certain creditors are authorized to impose a late fee pursuant to Section 687.03(2)(c), Florida Statutes:

"Notwithstanding any other provision of this section, any lessor or merchant, or any person who lends money or extends any other form of credit, who is regularly engaged in the business of selling or leasing merchandise, goods, or services which are for other than personal, family, or household purposes, or any assignee of such lessor, merchant, or person who lends money or extends any other form of credit, who is the holder of a commercial installment contract, each of which persons or entities is subject to the laws of any jurisdiction of the United States, any state, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or insular possession of the United States, may, if the contract so provides, charge a delinquency charge on each installment which is in default for a period of not less than 10 days in an amount not in excess of 5 percent of such installment. However, only one such delinquency charge may be collected on any installment, regardless of the period during which it remains in default. A delinquency charge imposed pursuant to this paragraph shall not be deemed interest or a finance charge made incident to or as a condition to the grant of the loan or other extension of credit and shall not be included in determining the limit on charges, as provided by this section, which may be made in connection with the loan or other extension of credit as provided by law of this state." (emphasis added)

Default Interest

In addition to late charges, most promissory notes also allow the imposition of a default rate of interest which is over and above the regular rate of interest charged under the note. For example, a typical note provision is as follows:

"DEFAULT RATE. In addition to all other rights contained in this Note, if a Default (defined herein) occurs and as long as a Default continues, all outstanding Obligations shall bear interest at the Interest Rate plus 6% ("Default Rate"). The Default Rate shall also apply from acceleration until the Obligations or any judgment thereon is paid in full."

Other default rate provisions state that upon default, the maximum legal rate of interest is imposed on all principal in default. In Florida, the maximum lawful rate of interest is 18 percent per annum simple interest for loans of \$500,000 or less and 25 percent per annum for loans in excess of \$500,000 (Florida Statutes Sections 687.03 and 687.071).

When reviewing loan documents to determine when a default rate of interest should be imposed, it is important to note whether the default rate of interest should be charged from the date of default or the date of acceleration. Lenders would tend to favor starting from the date of default and borrowers would prefer the date of acceleration. These are points to consider when drafting and reviewing promissory notes and related loan documents.

In one Florida case, the 5th District Court of Appeal considered a promissory note where the language of the note combined the acceleration provision and the imposition of default interest.

There the court held that default interest began accruing only after the lender had exercised its right to accelerate the full balance of the note. *Haddock v. Marlin*, 458 So.2d 848 (Fla 5th DCA 1984). In *Haddock*, the court also held that after the judgment was rendered in the lawsuit, the note interest rate decreased to the statutory interest rate on judgments set forth in Florida Statutes Section 55.03 (1). Since *Haddock*, the language of Section 55.03(1), Florida Statutes, has been revised, and the current statute provides: "Nothing contained herein shall affect a rate of interest established by written contract or obligation." As a drafting tip, lenders should consider reviewing their form promissory notes to make sure there is a provision allowing the default rate of interest to be imposed after a judgment on the note is rendered. See *Roger's Cushions, Inc. v. Baroody*, 683 So.2d 542 (Fla. 5th DCA 1996) and *Whitehurst v. Camp*, 699 So.2d 679 (Fla. 1997).

It should also be noted that lenders who advance funds to pay delinquent real estate taxes, assessments, insurance premiums and similar payments ("Impositions") may also be entitled to collect interest on such disbursements if the loan documents so provide. A sample mortgage provision allowing the lender to collect interest on such Impositions is as follows: *"Upon default of any such payment of any Imposition, Mortgagee may pay the same and the amount so paid by Mortgagee shall, at the Mortgagee's option, become immediately due and payable with interest at a rate of interest which is the highest rate of interest allowed by law and shall be deemed part of the indebtedness secured by this Mortgage."*

Grace Periods

Unless stated otherwise, the default rate of interest should not apply during a borrower's grace period. *Banksville, N.V. v. McNeill*, 529 So.2d 828 (Fla. 5th DCA 1988) ("Where days of grace are allowed on an instrument, the allowance is a matter of right and not a matter of grace. The allowance enters into, and forms a part of, the contract, and the instrument does not become due in fact or in law until the last day of grace. The maker of acceptor has the whole of the last day of grace in which to make payment, and he is not in default until the expiration of that day.")

The issues of calculating payoffs in a default situation, while on their face, appear straightforward, become more complex as the exact language of the loan documents is taken into account. As always, careful attention to such provisions should be made on the front end when the loan documents are being drafted and reviewed and on the back end when the loan is being paid off or the mortgage is being foreclosed upon. Careful consideration should also be paid when drafting notices of default and other correspondence to the borrower, as such documents can bolster defenses of estoppel or waiver in favor of the borrower.

For questions on this issue or other matters, please contact a [GrayRobinson Real Estate practice attorney](#).

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