

DEFLATING A BALLOON PARTIAL PAYMENT CONUNDRUM

Here's how to handle partial payments after loan maturity.

If you service loans with balloon payments, you have almost assuredly faced a situation where the loan has matured, but the borrower fails to remit the full payment amount owed. Instead, you receive a partial payment and are left with two options—reject or accept the payment. Many times, the servicer, generally at the direction of the lender, accepts the partial payment. But, by accepting, have you also inadvertently agreed to extend the loan terms? Moreover, if you accept do you also need to send a new notice of payment pursuant to Civil Code section 2924i? The answer is found in the interplay between California Civil Code section 2924i and any non-waiver clause contained in the loan documents.

HOW DOES CIVIL CODE SECTION 2924I APPLY TO BALLOON LOANS?

A balloon loan is a loan that does not fully amortized over the course of the loan term. That means any payments made by the borrower will not pay the loan off in full, which results in a large final payment at maturity. With respect to residential loans, the legislature decided that borrowers needed to be reminded of the final payment to ensure awareness of

what was coming due and adequate time to prepare. Thus, Civil Code section 2924i, which requires the servicer send a notice of final balloon payment to the borrower, was enacted. In short, the statute applies to balloon loans which are for a period of longer than one year, secured by a deed of trust on real property containing one to four residential units, of which at least one is occupied by the borrower. Civil Code section 2924i(a). The

statute requires the lender provide a notice of final payment to the borrower at least 90 days, but no more than 150, before the final payment is due. Civil Code section 2924i(c). This notice must identify the date the final balloon payment is due, the payment amount, where the payment should be sent, and whether the borrower has a contractual right to refinance. Civil Code section 2924i(c). Failure to send the notice timely does not invalidate the loan but will extend the loan terms via operation of law to a date at least 90 days after the notice date, thus delaying collection on the loan. Civil Code section 2924i(e), (f). Moreover, a willful violation of the statute can result in an award of actual damages and attorney's fees. Civil Code section 2924i(f).

As relevant to our question above, this section also states that “[i]f the due date of the final payment of a loan subject to this section is extended prior to the time notice is otherwise required under this subdivision, this notice requirement shall apply only to the due date



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CAN ACCEPTANCE ALONE EXTEND THE LOAN TERMS?

As a general matter the parties’ course of conduct, i.e., acceptance of partial payments post-maturity, can extend the loan terms, usually through application of equitable principles such as waiver or estoppel.

Waiver is the intentional relinquishment of a known right after knowledge of the facts. *Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 31. To succeed on his waiver claim, the borrower would need to prove by clear and convincing evidence that the lender freely and knowingly gave up its right to require the borrower to pay the full amount owed on the maturity date. *Id.* Notably, a waiver can be oral, written or it can arise from conduct that shows the lender clearly gave up the right. *Id.*, see also *Howard J. White, Inc. v. Varian Associates* (1960) 178 Cal.App.2d 348, 353-355.

Estoppel is an equitable doctrine codified in California Evidence Code section 623, which provides that when a party, by either statement or conduct, leads another to believe a particular thing is true and the second party acts in reliance thereon, the first party is not permitted to contradict that statement or conduct in any litigation arising out of that statement or conduct. Cal. Evid. Code section 623. To succeed on an estoppel claim, the borrower would need to show that the lender knew about the breach of the loan payment terms but extended the loan term by accepting the partial payment, that the lender intended its conduct to be acted upon, that the borrower did not know differently that the loan had not been extended, and that the borrower relied upon the

statement or conduct to his detriment. *DRG/ Beverly Hills, Ltd. V. Chopstix Dim Sum Café & Takeout III, Ltd.* (1994) 30 Cal.App.4th 54, 59.

HOW DO I PROTECT MYSELF?

While the lender’s course of conduct/ acceptance of payment can potentially extend the loan terms, generally all loans also contain an anti-waiver clause specifically to prohibit such an occurrence. (Note: if your loan documents do not contain one, they should!) Anti-waiver clauses generally provide that a lenders’ failure to enforce its contractual rights in a breach situation shall not constitute a waiver of that breach or the remedies available to the lender. Many also specifically provide that acceptance of late payments or partial payments does not constitute a modification of the loan or a waiver of any other remedy available by law. These clauses are consistently upheld by courts across the nation based on their plain language, but enforcement is based on the parties’ actual conduct, which must be consistent with the anti-waiver clause terms.

Here, assuming the lender’s loan documents contain an anti-waiver clause which covers acceptance of payments post-maturity, the lender’s mere acceptance of the partial payment would not extend the loan terms. This is, of course, subject to the above caveat that the lender’s other conduct is consistent. For instance, if the servicer orally represents to the borrower that the loan due date has been extended or a monthly statement is sent to the borrower showing a different due date post acceptance of the partial payment, a court could find that the lender waived the anti-waiver clause protections based on that separate conduct. As a best practice, in situations where the lender decides to accept the partial payment, we recommend the servicer also send a reservation of rights letter to the borrower specifically advising them that acceptance of the payment is not to be considered a modification of the loan or a waiver of any of

the loan terms. This letter would not only cut against any argument by the borrower that the lender intended to modify the loan, but also be strong evidence that the borrower knew the acceptance was not a modification of the due date.

We are aware that some servicers will sometimes send a new 90-day notice under Section 2924i if they accept a partial payment. However, we do not recommend such a course of action for two reasons. First, logic dictates that since the loan terms have not been extended, a new 90-day notice is not necessary to comply with the statute’s requirements. Second, sending such a notice could be problematic because it could be used by the borrower as evidence that the lender intended to voluntarily extend the due date, otherwise why did the lender send the new notice in the first place.

In summary, first check your loan documents and review the anti-waiver provision. If it does not already specifically address acceptance of late/partial payments, consider revising it. Next, consider implementing a policy requiring a reservation of rights letter be sent to the borrower in situations where a partial payment is going to be accepted post-maturity. Ultimately, if you are unsure what level of protection you currently possess, please reach out to Wright, Finlay & Zak, LLP or your counsel to discuss your specific situation.



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