Past Crises Model Virus Response For Mortgage Industry

By Allison Schoenthal (March 26, 2020)

To prepare for the impact of COVID-19 on the mortgage industry, in the short and long term, lessons can be learned from prior natural disasters. Superstorms Sandy, Irma, Harvey and Maria, to name a few, had a massive financial impact on homeowners, and therefore on banks and loan servicers as well.

Allison Schoenthal

The mortgage industry must quickly ramp up to address the fallout from COVID-19, and can prepare and anticipate issues by looking at prior natural disasters.

Effect of the Foreclosure Moratoriums

On March 18, President Donald Trump announced he had directed the U.S. Department of Housing and Urban Development to suspend all evictions and foreclosures on HUD-backed properties until the end of April. On the same day, HUD announced a 60-day foreclosure and eviction moratorium applicable to single-family homeowners with Federal Housing Administration-insured mortgages, and the Federal Housing Finance Agency directed Fannie Mae and Freddie Mac to suspend foreclosures and evictions for at least 60 days.

The HUD moratorium requires that servicers suspend all foreclosure actions on properties subject to mortgages insured by the Federal Housing Administration — both forward mortgages and home equity conversion, or reverse, mortgages. This will pause foreclosure actions that are currently in process and halt all new foreclosure actions.

HUD has also encouraged servicers to offer loss mitigation strategies to borrowers, including "short and long-term forbearance options, mortgage modifications, and other mortgage payment relief options." The impact of these moratoriums will be vast. According to the FHA's website, the HUD moratorium alone will apply to over 8 million single-family mortgages that are insured by FHA mortgage insurance.

We have seen such moratoriums before. HUD implemented a series of moratoriums on foreclosures of properties in presidentially-declared major disaster areas for a 90-day period, and suspended certain evictions, following Superstorms Sandy, Harvey, Irma and Maria.

Fannie Mae and Freddie Mac have also previously directed that foreclosures and evictions be suspended in federal disaster areas. Servicers should expect that the recently announced moratoriums may be extended, particularly in areas that are most significantly impacted. This was the case with the prior moratoriums, which were each later extended by HUD.

It is also possible that major mortgage lenders will take additional voluntary measures to halt foreclosure proceedings to allow homeowners time to work on loan modification plans with their servicers, and to financially recover.

Many states and cities have enacted their own foreclosure relief measures, and more are expected.

For example, the New Jersey legislature enacted a statute that permits the governor to issue an executive order preventing tenants or homeowners from being removed from a residential property as the result of eviction or foreclosure for up to two months after the end of a declared public health emergency or state of emergency.

New Jersey Gov. Philip Murphy issued such an executive order on March 19, ordering sheriffs, court officers and their agents to "refrain from acting to remove individuals from residential properties through the eviction or foreclosure processes ... unless the court determines on its own motion or motion of the parties that enforcement is necessary in the interest of justice."

In South Carolina, the South Carolina Supreme Court issued an order calling for an indefinite moratorium on any foreclosure hearings, sale of foreclosed property or other court orders mandating people leave their homes. Similar actions have been taken in California, Indiana, Kansas, New York and Pennsylvania, among others, and will be taken by additional cities, county and state governments.

Banking regulators may also take actions designed to shape how banks and mortgage servicers respond to the crisis. For instance, New York's Department of Financial Services, or DFS, has issued guidance urging mortgage servicers to take a number of steps to alleviate the adverse impacts of COVID-19 on borrowers including: forbearing mortgage payments for 90 days; refraining from reporting late payments to credit rating agencies for 90 days; and halting foreclosures for 90 days.

Servicers therefore need to comply with the current moratoriums, be prepared in the likely event they are extended, and monitor for additional guidance and dictates from local governments and state regulators. Implementing the various state, federal, and local directives can be a challenge for a servicer, and the effect of the directives can be confusing for a mortgagor. Homeowners will surely inquire about how the announced federal moratoriums and other local actions will or will not impact their loans, and servicers must be prepared to respond.

Servicers will need to determine if the moratoriums impact other obligations as well. For example, New York law requires mortgagees and servicers to inspect, secure and maintain abandoned one-to-four family residential real property securing mortgage loans and to register such properties with DFS.

Violations of the New York law may trigger civil penalties of $500 per day per property, which can result in substantial fines. In one recent case involving only two properties, DFS assessed a $100,000 fine.

Compliance with such a law may prove challenging in the face of limited personnel to inspect and repair properties and longer timelines to complete foreclosures on vacant or abandoned properties. Because many similar laws are relatively new, servicers should take steps now to ensure they are ready to comply.

Prior moratoriums have also raised questions about whether the statute of limitations or other deadlines were tolled. For example, if a foreclosure cannot be started or restarted within the statute of limitations period due to the moratorium, will it be time barred? The New York governor has issued an executive order tolling "any specific time limit for the commencement, filing, or service of any legal action, notice, motion, or other process or proceeding, as prescribed by the procedural laws of the state" until April 19.

The effect of that order will surely be debated in pending and future actions. Other jurisdictions and courts may issue similar orders, but once the moratorium expires, servicers must be prepared to timely initiate foreclosures on defaulted loans, resume pending foreclosures, schedule foreclosure sales and issue default notices on newly defaulted loans.

Customer Communications

Lessons from the 2008 financial crisis and prior natural disasters counsel that mortgage servicers must prepare now to field an influx of consumer inquiries. As some homeowners begin to miss paychecks due to the impact of COVID-19, mortgage servicers should be prepared to advise customers on issues including missed or delayed payments, forbearance and modification programs, credit reporting and requests to waive late fees.

Preparation should include preparing call scripts and letter templates, conducting targeted trainings, and increasing staffing for call centers and correspondence groups. Servicers should also track customer complaints to identify weakness in consumer communications and other areas where improvement is needed.

Credit Reporting

As was the case following recent superstorms, the financial challenges that will follow COVID-19 threaten to negatively impact customers' credit scores. In the wake of other natural disasters, many loan servicers adopted forbearance programs that waived fees for late payments, and permitted homeowners to skip or make partial payments for a period of time without triggering delinquency reports to credit reporting agencies.

As noted above, New York's DFS is calling on servicers to implement similar measures now. Fannie Mae issued a March 18 lender letter directing servicers to suspend credit reporting "during an active forbearance plan, or a repayment plan or Trial Period Plan where the borrower is making the required payments as agreed, even though payments are past due, as long as the delinquency is related to a hardship resulting from COVID-19."

Similar action was taken by Freddie Mac, on the same date. In addition, proposed federal legislation would, if enacted, create a moratorium on negative consumer credit reports. Whether enacted voluntarily or in accordance with a government dictate, these procedures must be properly implemented, and the impact on credit scores clearly explained to customers, to avoid later litigation.

Any automated processes to report credit scores must also be adjusted to ensure compliance with any federal and state directives prohibiting negative credit reporting for customers impacted by COVID-19.

Increased Litigation and Enforcement

Servicers should also anticipate increased foreclosure litigation once the moratoriums have ended. If the 2008 financial crisis and prior disasters are used as a guide, servicers can expect future lawsuits to raise claims regarding: alleged breach of moratorium agreements; allegedly deceptive or confusing notices to customers; mortgage relief scams; disputes over the impact of the moratorium on the statute of limitations for foreclosure actions and other claims; alleged failures to provide loss mitigation; negative or incorrect credit reporting disputes; delayed mortgage closings; and breach of sale contracts or settlement agreements due to delays related to COVID-19.

There is also no doubt there will be future regulatory investigations into the mortgage industry's response to COVID-19 and compliance with the federal and state directives issued in response to the COVID-19 outbreak. It is worth documenting compliance now, to avoid issues later.

Conclusions

The effects of the COVID-19 pandemic are already widespread and are sure to be felt by the mortgage loan industry long after the pandemic ends. Servicers must apply lessons they have learned since 2008 to prepare now, to both help impacted customers and to expedite the recovery period for the mortgage industry.

Allison Schoenthal is a partner and head of the consumer finance litigation practice at Hogan Lovells.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.