Memorandum Regarding The Impact of Foreclosure Moratoria on the Mortgage Default Legal Services Community

Purpose

The purpose of this information is to help to educate those looking to institute rules and policy regarding mortgage servicing industries and providing assistance in understanding the negative impact of any foreclosure moratoria on mortgage default law firms.

Background

As the United States prepares for the impact of the COVID-19 Virus on its economy and its individual consumers, mortgage servicers are considering the best ways to assist consumers affected by the pandemic. The industry's law firm partners and their employees are also affected by the pandemic. The continued viability of the law firms serving the industry should also be considered in making these decisions.

The economic impact that any drastic decisions will have on the industry will impact tens of thousands of jobs, many of which will never come back. A proper balance needs to be considered between helping effected borrowers and those that work for banks and mortgage servicers. This work is being done to support the financial services sector, and particularly the mortgage servicing world, which is itself the backbone of the entire real estate market (a huge percentage of the U.S. economy).

Default Firms and the Impact of the Pandemic

Each mortgage servicer has a network of law firms which provide default legal services. Many of the firms have 30 or more years' industry and default related experience. Such law firms are regularly vetted by mortgage servicers to ensure that they meet high levels of quality in process coupled with effective security and compliance programs at the intersection of privacy laws, consumer protection laws, regulations and government/consumer interaction.

Servicers invest significant resources in onboarding and managing these firms to ensure their compliance with regulatory and industry standards. The firms, likewise, have significant investment in expertise, personnel and infrastructure to meet the ever tightening standards of performance in this crucial arena. Moreover, the firms typically operate successfully on ever smaller margins due to industry regulated controls on attorneys' fees in the face of such high investment. Those margins have been further narrowed in recent years as default volumes declined while compliance and technology costs remained level or increased.

As a result of the pandemic itself and delays and additional costs imposed in each jurisdiction due to the pandemic, the default law firms are not only facing significant expenses that other businesses face, such as employee sick leave cost and work from home transitioning, but they face a reduction in matters to process, resulting in lower revenue to address these issues.

Given the environment already facing these firms, the recently announced moratoria by the Federal Housing Administration (FHA) and Federal Housing Finance Agency (FHFA) has potentially terrible consequences for default firms nationwide. This approach has been used previously with small time frames and limited files, and thus the industry is familiar with the impacts, on consumers, loan servicers, and the providers of default legal services. While past moratoria were disruptive to the industry, the wide breadth of moratoria currently being imposed (not just the delay or postponement of sales, but a prohibition against processing any part of the foreclosure process), could prove disastrous to legal service providers.

This will impact several hundred firms across the country and tens of thousands of employees.

Potential Impact of a Foreclosure Moratorium on the Firms

Such wide ranging and blanket moratoria would artificially extend the period of time in which default firms income is dramatically reduced while current stresses caused by the pandemic as well as ongoing overhead in security and compliance continue. Already operating on narrow margins, many default legal service providers will likely be required to impose work force reductions, or forced to shut down completely (and possibly permanently). The loss of these business partner firms could have a dramatic impact on the industry which will still need to process in process foreclosures now as well as new matters, all with quality, security and professionalism once this pandemic crisis wanes and moratoria and other delays end. Even the surviving firms will likely have reduced capacity and require time and resources to rebuild once the pandemic wanes.

The in-process foreclosure files can't be simply placed on hold. In many states, these files are involved in a judicial process which as a matter of course needs to be managed through the court system by the attorneys handling the case. They cannot just drop their responsibilities to their client. The firms are typically compensated on the basis of meeting specific benchmarks or "milestones". Since the moratorium impedes any additional milestone, the default attorney must perform their professional obligation without any compensation going forward for however long the moratorium goes on. Additionally, the firm must also provide support and service with respect to payoff requests, reinstatement requests, review of bankruptcy filings and review of Servicemembers Civil Relief Act (SCRA) and other responsibilities to ensure that the borrower's receive information that they need or request and also to ensure that the borrower's rights are protected at the completion of the moratorium. Regulatory and compliance requirements force the law firms to retain personnel in non-income producing roles, all at a time when the primary revenue stream has been cut off.

Firms in non-judicial foreclosure states will have similar court responsibilities with respect to eviction cases, or cases involving probate or special home equity actions. Firms in non-judicial states have all of the same issues with respect to bankruptcy and SCRA. The moratorium creates a dramatic amount of duplicate work, from files needing to be re-posted or re-published for foreclosure a second time to judgments which will need to be amended because of advances which occur during the moratorium. The law firm, maintaining the file will incur costs to protect the borrower as well as its client as a result of the moratorium.

Ways to Reduce the Impact of Any Moratorium on the Firms

Even where moratoria are the best reaction in light of all considerations, some steps can be taken to reduce these impacts on the law firms providing default related services. First, the moratoria could be limited to referrals to foreclosure where the defaults resulted from the pandemic. Loans in pending foreclosures, typically filed after at least 120 days of default pursuant to 12 CFR 1024.41(f)(1), are not in default because of the pandemic. Moreover, these cases are already delayed by the impact of the pandemic on our judicial system and other governmental agencies. Once the court or state infrastructure will allow these matters to proceed, such matters should proceed.

An additional consideration might be to limit moratoria to completion of the foreclosure sale, rather than any foreclosure activity. For example, in judicial foreclosure states, complaints could be filed and judgments entered but sales themselves delayed for a short period of time. In non-judicial states, foreclosure sales could be scheduled for a time outside the limits of the moratoria, allowing for title review and necessary noticing. A limited approach such and this would allow the firms to continue to employ experienced workers and bill at completed milestones while allowing additional time for consumers to seek loss mitigation alternatives and/or get back on their feet once the pandemic wanes.

Regardless of the breadth of the moratoria, the economic impact of these delays should be addressed through the payment of additional fees and costs to the law firm partners in order to compensate the firms for potential carrying costs, risks, and additional exposure due to these delayed files and any work which may be required during these delays.