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Mortgage & Structured Finance

March 31, 2020

Potential Consequences to Mortgage Servicers of COVID-19 Delinquencies and Expanded Forbearance Programs–March 31 Update

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In response to the challenges posed to U.S. mortgage borrowers as a result of the COVID-19 pandemic, Freddie Mac, Fannie Mae, and the Department of Housing and Urban Development (HUD), including the Federal Housing Administration (FHA), have expanded their forbearance programs for those who have lost income due to the pandemic. Other private lenders followed suit and more are expected to do so. On March 27, 2020, President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), a $2 trillion economic stimulus bill. The CARES Act includes broad protections for homeowners who are experiencing financial hardship as a result of the coronavirus outbreak. Such protections include forbearance developments in line with those previously announced by Freddie Mac, Fannie Mae, and HUD:

- The CARES Act allows mortgagors with federally backed mortgage loans on single-family residences, regardless of delinquency status, to request loan forbearance for an initial period of 180 days, and that forbearance could be extended for another 180-day period if necessary.
- Mortgagors must contact their mortgage servicers directly in order to request the forbearance.
- Mortgagors with federally backed multifamily mortgages who are current on their payments may request forbearance for up to 90 days.

While these measures are a welcome balm to borrowers, they compound the serious issues faced by the mortgage servicing industry due to the waves of missed mortgage payments expected in the coming months.

Typically, when a borrower fails to make a monthly mortgage payment, the mortgage servicer has an obligation to advance the scheduled payment of principal and interest to investors who own the loan in a mortgage-backed security. The majority of mortgages originated in the United States mortgage market are securitized into mortgage-backed securities. The mortgage servicer's obligation to advance delinquent principal and interest is in addition to its obligation to advance any delinquent real estate taxes, homeowners insurance, and mortgage insurance on behalf of the mortgagor.

Mortgage servicers of federally backed mortgage loans, therefore, may be on the hook to advance the monthly payments subject to forbearance pursuant to the CARES Act. Based on the number of federally backed mortgage loans and the unprecedented number and size of mortgage loan forbearances and delinquencies expected, the required advances are expected to far exceed liquidity facilities and cash reserves used by mortgage servicers to fund these advance obligations. While industry participants had specifically requested them, the CARES Act did not provide any sources of liquidity for mortgage servicers. If the federal government does not intervene with a plan to provide additional liquidity to mortgage servicers, they will be unable to meet their obligations to investors.

On March 22, 2020, the Mortgage Bankers Association (MBA) sent a letter (the MBA Letter) to Federal Reserve Chairman Jerome Powell and Treasury Secretary Steven Mnuchin, asking for public sector support for mortgage servicers. In the letter, the MBA estimates that if about a quarter of all borrowers request and are granted mortgage loan forbearance for six months or longer, advance demands on servicers could exceed $75 billion and could climb well above $100 billion. Virtually no mortgage servicer will be able to meet advancing obligations on this scale, and the result will be devastating to the mortgage finance system. In the MBA Letter, the MBA makes the following recommendations:

- The Federal Reserve should immediately establish liquidity facilities to support mortgage servicers and allow them to meet their increased advancing obligations.
- Such program should be enacted by the Federal Reserve through its authority under Section 13(3) of the Federal Reserve Act to provide liquidity for the residential mortgage servicing sector, which program should be supported by credit protection from Treasury's Exchange Stabilization Fund.
- The plan to create such liquidity facilities should be announced and developed in advance of any obligations that mortgage servicers must meet due to borrower forbearance or increased delinquency related to COVID-19 in order to provide stability to the market and ensure the success of the forbearance programs being implemented by lenders.

These concerns and recommendations for federal support for mortgage servicers were echoed in a second letter (the Industry Group Letter) sent by mortgage industry groups including the MBA; the American Bankers Association; the Consumer Data Industry Association, which includes Experian, TransUnion, and Equifax; the Structured Finance Association (SFA); the National Mortgage Servicing Association; U.S. Mortgage Insurers; and the Housing Policy Council, a trade group whose membership includes Citigroup, Black Knight, Caliber Home Loans, First American, JPMorgan Chase, Mr. Cooper, Quicken Loans, Wells Fargo, and many more of the largest mortgage companies in the industry. The Industry Group Letter was sent March 22, 2020, and was addressed to the Department of the Treasury, the Federal Reserve, the Consumer Financial Protection Bureau, the Federal Housing Finance Agency, HUD, and the White House's National Economic Council.

On March 23, 2020, the Federal Reserve announced the reestablishment of the Term Asset-Backed Securities Loan Facility (TALF). TALF was initially established in connection with the 2008 financial crisis. It is a credit facility authorized under Section 13(3) of the Federal Reserve Act intended to help meet the credit needs of consumers and small businesses by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for ABS. While the Federal Reserve intends to announce more details regarding the terms of TALF, it has said that the terms and conditions will be primarily based on the terms and conditions used for the original TALF program. Mortgage industry leaders and lobbying groups, including the SFA, have been pushing for an expansion of what will be considered eligible collateral for ABS under TALF to include residential and commercial mortgage-backed securities, but it remains to be seen how the Federal Reserve will modify TALF.

The Federal Reserve has made the Term Sheet for TALF available here.

The Term Sheet states that "eligible servicing advance receivables" are eligible collateral for ABS under TALF. Some in the industry are hopeful that this inclusion indicates that mortgage servicers may be able to obtain financing for their advancing obligations through TALF, but further clarification from the Federal Reserve is needed before that ability can be truly assessed.

A large-scale default by mortgage servicers to meet their advancing obligations would be devastating to the mortgage finance industry and the economy. In response to these industrywide concerns, on March 28, 2020, Ginnie Mae, which currently holds approximately 29.6 percent of the outstanding securities in the agency market, announced that within the next two weeks it will implement a pass-through assistance program (PTAP) through which issuers with a shortfall with respect to principal and interest payments may request that Ginnie Mae advance the difference between available funds and the scheduled payment to investors. This PTAP will be accompanied by corresponding changes made to Ginnie Mae's MBS Guide in due course. Ginnie Mae anticipates implementing the PTAP for single-family issuers initially, and expects PTAP terms for reverse mortgage and multifamily issuers to be published shortly thereafter. The MBA praised this announcement by Ginnie Mae, and the mortgage finance industry is hopeful that further decisive federal action to provide support and liquidity to mortgage servicers will be forthcoming. However, whether further support will come and what form it will take remain uncertain.

We will be updating this article periodically as new developments occur in the mortgage finance market with respect to the response to the COVID-19 pandemic.

To see our prior alerts and other material related to the pandemic, please visit the Coronavirus/ COVID-19: Facts, Insights & Resources page of our website by clicking here.

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