Servicing Transfers During Loss Mitigation, including Note Sales by FHA/FHFA

Summer Mortgage Conference

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Servicing Transfer Requirements

• Privately enforceable requirements:

  • New servicer must comply with § 1024.41 even if borrower’s prior applications with former servicer were evaluated – OI, ¶ 41(i)-1

  • Documents and information transferred from a former servicer to new servicer may be a loss mitigation application and may require a new servicer to comply with § 1024.41 – OI, ¶ 41(i)-1

  • When a mortgage is transferred, new servicer must obtain loss mitigation documents and information submitted by borrower to former servicer and comply with § 1024.41 – OI, ¶ 41(i)-2
Servicing Transfer Requirements

• Privately enforceable requirements:

  • If borrower’s application is complete and being evaluated when mortgage is transferred, new servicer should “continue the evaluation to the extent practicable” - OI, ¶ 41(i)-2

  • Documents in a complete application are received for purposes of timelines as of date they were received by former servicer, not new servicer - OI, ¶ 41(i)-2

  • NOE covered error includes: “Failure to transfer accurately and timely information relating to servicing of a borrower’s mortgage loan account to a transferee servicer” - § 1024.35(b)(7)
Servicing Transfer Requirements

- General servicing requirements (not directly enforceable through private right of action under RESPA):
  - Transferor servicers must have policies and procedures to ensure that documents and information relating to a transferred mortgage loan are transferred to the new servicer in a timely and accurate manner — § 1024.38(b)(4)(i)
  - A transferee servicer must identify necessary documents or information that may not have been transferred by a transferor servicer and obtain such documents from the transferor servicer — § 1024.38(b)(4)(ii)
  - “A transferor servicer's policies and procedures must be reasonably designed to ensure that the transfer includes any information reflecting the current status of discussions with a borrower regarding loss mitigation options, any agreements entered into with a borrower on a loss mitigation option, and any analysis by a servicer with respect to potential recovery from a non-performing mortgage loan, as appropriate.”  OI, ¶ 38(b)(4)(i)-2
Recent Decisions

  - Transferor Chase failed to transfer application documents (§ 1024.38(b)(4)(i))
  - Transferee Caliber demanded new application and failed to evaluate one submitted to prior servicer (§ 1024.38(b)(4)(ii))
  - Court did not consider that § 1024.38 is not privately enforceable
  - Better to characterize as failure to evaluate under § 1024.41 or set up using NOE
  - Damages – rejects “borrower’s own default” as cause of all damages

- Dent v. Inv. Corp. of Am., 2015 WL 9694807, at *5 (E.D. Mich. Dec. 23, 2015) (“Mortgage servicers thus may not escape their duty to address loan modification requests by simply noting that such requests were made to a prior servicer.”).
Distressed Loan Sales

- Who is selling them?
  - Government guarantors & insurers
  - FHA, Fannie Mae, Freddie Mac
    - 2010-12 foreclosure backlog
    - Mostly in judicial foreclosure states
    - Sales cut insurance losses
  - Private loan owners selling too
    - e.g. Bank of America direct sales to investors
Distressed Loan Sales

• Who is buying them?
• Hedge funds & private equity firms
  • Bayview Asset Acquisitions (Blackstone)
  • Lone Star Funds (Caliber)
    • Purchased 22,447 FHA loans in single auction 6/11/14 for $3.9 billion
  • Selene Investment Partners (Lewis Ranieri)
• Non-profits – about 2% through DASP
Distressed Loan Sales

• What are they doing with the loans?
  • Buyers securitize distressed assets
  • Re-sell loans for a profit
  • Large investors creating single-family rental industry & marketing bonds
    • Invitation Homes – owned by Blackstone
    • American Homes 4 Rent
HUD’s Distressed Asset Sales Program ("DASP")

What it involves:

• FHA-insured loans
• In default, but pre-foreclosure sale
• Grouped in pools (100-1000+ loans per pool)
• HUD sells the loan pools at public auctions
DASP - Purpose

• According to HUD, two goals:
  • Revenue for insurance fund, cover past losses, reduce future damage from delayed foreclosures
  • Allow more flexible loss mitigation options (i.e., principal reduction) for borrowers
DASP Mechanics

- No foreclosure sale before HUD pays claims
- HUD pays off lender/servicer’s claims as DASP sale completed
- HUD used to pay off claims only after servicer completed sales
- Statute changed to allow HUD to pay claims off before sales (loans three months in default) 12 U.S.C. § 1710.
DASP- Effect on Borrowers

- Note transferred to HUD
- Mortgage assigned to HUD
- Transfer to new private buyer purports to end loan’s participation in FHA program
- Decisions on loss mit. and foreclosure now up to loan’s new owner
DASP – Effect on Borrowers

• Note sales short-cut state foreclosure procedures
• Many recent state laws require mediation, documentation of loss mitigation reviews
• DASP sales remove loans from procedures that hold FHA servicers accountable for compliance with FHA rules
• Philadelphia, New York mediation examples
DASP – Two Types of Loan Pools

- National Pools
- Neighborhood Stabilization Outcome ("NSO") Pools (focus on a city or region)
DASP – What Happens to “NSO” Pools?

• Bidder must qualify under special bidding contract (may be a non-profit, but don’t have to be one)
• No foreclosure sale for 12 months after purchase (previously 6 months)
• Must meet target outcomes for 50% of loans in pool
• Four years of reporting to HUD
• Penalties possible if fail to meet 50% target
• Must evaluate borrowers for a “HAMP-like” modification
  • Not clear what this means or how is enforced
DASP – What are Countable “NSO” Outcomes

- For 50% of loans in pool purchaser may do one of following:
  - Collect payments for 6 mos.
  - Short sale to a new owner-occupant
  - Rent property out for three years
  - Give away to non-profit
- For the other 50% of loans in NSO Pool, no limits on disposition
DASP – What Happens to National Pools?

• Some changes prospective from April 2015:
• No foreclosure sale for 12 mos. (formerly 6 mos.) after purchase
• Must evaluate borrowers for a “HAMP-like” modification
  • Not clear what this means or how is enforced
• No restrictions on disposition after 12 mos.
DASP Numbers

- FHA loans sold to May 2016: 112,892
- FHA loans sold just in 2014: 45,979
- Total value of loans sold: $18 billion
- About 98% of FHA loans are bought by for-profit entities
- Percent of BPO recovered (2014-15):
  - 68%-78%
- Percent of UPB recovered (2014-15)
  - 52%-66%
2014 DASP Sales Breakdown

• June 11, 2014
  • 22,447 loans (national unrestricted pools)
• June 25, 2014
  • 4,224 loans (NSO pools)
• September 30, 2014
  • 14,023 loans (national unrestricted pools)
• November 19, 2014
  • 5,285 loans (NSO pools)
DASP “Aged Portfolio” Sale

• May 18, 2016
• 7,892 loans sold, on average more than 48 months delinquent
• Heavily from NY, NJ, MD
• Recovery of 50-60% BPO and 40-60% of UPB
DASP Sales

• Whose loans are these?
  • March 2013 NSO pools – all from BofA
  • June 2013 National Pools – 75% BofA & Chase

• Where do they come from?
  • National Pools – Heavily FL, NY, NJ, OH, IN
  • NSO Pools – Many in Chicago, Ohio & Florida metro area pools, more recently Maryland, Calif. June 2014 - Detroit
DASP Sales - Problems

• Did servicer/owner effectively review for all FHA loss mitigation options before payoff and transfer of loan to HUD?
  • Review at specific time frames: at 90 days, then ongoing monthly
  • Notices, face-to-face meeting before foreclosure
• Notice of DASP sale to Borrower
  • No roadmap
  • Need more than RESPA servicing transfer notice
  • In HUD’s view, ongoing participation in insurance program terminated
DASP Sales

- Litigation issues
- Available claims will depend heavily on state law – e.g. contract claims, UDAP
- May be hard to claim that the borrower is a third party beneficiary of the note sale contract.
- Loss of bargained-for FHA insurance benefits as breach of contract, due process violation?
DASP Sales

• Lenders will argue that because the loan is no longer FHA insured, the regulations, and any non-compliance, no longer apply.
• But the non-compliance likely occurred while the loan was still FHA insured
• Argue the acceleration pre-DASP sale was invalid under loan documents and 24 C.F.R. §§ 203.600, *et seq.*
DASP Sales

• As a general principle, the sale of the loan should not by itself cure failure to comply with FHA regulations.
  • The new servicer receives the loan with the non-compliance already in place.
  • Rather than starting fresh and forgiving past due payments that accrued while the loan was insured, the new servicer often pursues the entire amount that the previous lender claimed due
Breach of Contract

• The foreclosing party’s duty to comply with FHA servicing regulations is expressly incorporated into the mortgage and note

• “This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary.”
Parties Liable

• It may be beneficial to have the old owner in the lawsuit – it will provide an opportunity to address the former owner’s non-compliance.

• Consider UDAP claim against former FHA servicer that certified to HUD it had complied with FHA loss mitigation guidelines
GSE Loan Sales

- **Freddie Mac**
- 200,000 delinquent loans 90+ days (12/14)
- 7 loan sales held from July 2014 to Sept. 2015 (20,456 loans sold for $4.5 billion)
- High share in judicial states (FL, NY, NJ)
- Two classifications
  - Standard Pool Offerings
  - Extended Timeline Pool Offerings
GSE Loan Sales

- Recent Freddie Mac sale (Sept. 2015)
- 5774 Ocwen loans sold for $1.1 billion
- On average 3.5 years delinquent
- One-third previously modified
- Three largest of five pools purchased by Lone Star affiliate
Freddie Mac NPL Sales

NPL Sales - Number of Loans Auctioned by Half Year

- 2H:2014: 3,044
- 1H:2015: 8,582
- 2H:2015: 15,790
- 1H:2016: 7,303
GSE Loan Sales

- **Fannie Mae**
  - 2015: 14,100 distressed loans sold
  - 2016 (Jan. – July): 18,200 offered
    - pools sold for 50-70% of BPO
    - Avg. 3-5 years mos. in arrears
    - Small pools (typically 100 or fewer loans) for non profits
GSE Loan Sales

• General FHFA post-sale requirements (March 2015)
  • Pre 2009 borrowers must be evaluated for Treasury HAMP (but HAMP expiring 12/16!)
  • Post 2009 borrowers for proprietary mod without fees or prepayment
  • Complete pending applications & maintain prior modifications
  • Waterfall requirement (foreclosure last option)
  • Servicer obligations transferable
GSE Note Sales

- FHFA changes announced April 14, 2016
- To require buyers review for principal reduction, but
  - Requires only review in limited cases
  - Subject to proprietary NPV test
  - No real limit on servicer discretion in review
- Limit on post-modification interest rate increases
  - Curtails the Lone Star/Caliber abuse of 5-year forbearance plans
RESPA Claims and Note Sales

• RFI to buyer for pre-sale loss mitigation records of selling servicer
  • NOE to new servicer based on non-compliance with FHA contract documents?
• RFI for buyer’s loss mitigation review activities and standards
  • New servicer, new application
  • Must review consistently with FHA and GSE guidelines for note purchasers
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