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Mortgage Loss Mitigation in a Post-HAMP World

by Michael J. Steinlage

On December 31, 2016, the Federal government's landmark loan modification program, commonly known as HAMP, comes to an end. Regardless of how one judges the relative success or failure of the program, it is undeniable that HAMP sparked a sea change in thinking about how the mortgage industry approaches loan defaults. "Loss mitigation," once a euphemism for foreclosure, is now a critical aspect of servicing operations that encompasses a wide range of forbearance options designed to minimize the deleterious effects of foreclosure and, where possible, keep people in their homes.

And yet, despite all of these changes, the standard form mortgage that governs the parties' rights and obligations has not changed. Foreclosure remains the primary remedy for a borrower's failure to make timely payments. Forbearance, to the extent it is addressed at all, is recognized as a temporary measure within the sole discretion of the mortgagee, with the right to strictly enforce the terms of the mortgage expressly preserved.

This article will review the measures that have been taken, beginning with HAMP, to close the gap between the limited rights and remedies available to mortgagees and borrowers under standard loan documents and the more permissive and borrower-friendly approach to delinquency and foreclosure that came into practice during the mortgage foreclosure crisis and that many government officials and consumer advocates hope to make a permanent element of loan servicing practices.

Balancing the Need for Emergency Action with Traditional Contract Rights

In February 2009, under the authority granted in the Emergency Economic Stabilization Act ("EESA"), the Department of the Treasury ("Treasury") announced formation of the Making Home Affordable Program ("MHA"), which established various programs designed to encourage mortgage lenders to work with at-risk homeowners. The centerpiece of MHA was the Home Affordable Modification Program ("HAMP"), which created financial incentives for loan servicers and investors to encourage them to modify the terms of existing private mortgages where modification was in their financial interests.

When HAMP was enacted, it was recognized that the government could not unilaterally require private mortgage holders to modify the terms of their credit agreements and mortgages. HAMP attempted to strike a balance between the contractual rights and remedies of noteholders and the goals of the EESA by creating financial incentives for loan servicers to pursue loan modifications in lieu of foreclosure.

Participation in HAMP was voluntary for servicers of privately held loans and accomplished through a written agreement between the servicer and Fannie Mae, as financial agent for the federal government, in which the servicer agreed to adhere to the requirements of the Program. The participation agreement did not abrogate or overrule existing contractual obligations. On the contrary, the agreement specifically acknowledged that the "[S]ervicer … may be subject to restrictions set forth in pooling and servicing agreements or other servicing contracts governing Servicer's servicing of a mortgage loan …." While participating servicers were expected to make reasonable efforts to obtain consent from investors to follow HAMP, servicers were not required to pursue modifications where "the investor is not willing to participate in HAMP." Thus, as originally structured, HAMP affirmed the primacy of

contractual rights and remedies and recognized that modifications could not be forced upon the owners of privately-held mortgages.

Comparison to Other Historical Government Actions

HAMP is not the first example of the government taking action to suspend or delay creditor remedies in times of economic turmoil. In *Home Building & Loan Association v. Blaisdell*, the United States Supreme Court considered the constitutionality of a Minnesota law enacted during the Great Depression which authorized courts to extend the redemption period following a foreclosure sale (during which time a borrower could continue living in the home) for such additional time as the court deemed "just and equitable." 290 U.S. 398 (1934). Although conceding that the rights of the holder of the mortgage contract were impaired by the act, the United States Supreme Court held that the impairment was within the police power of the state as called into exercise by the public economic emergency that the state legislature found to exist at the time. *Id.* at 479 ("the relief afforded by the statute does not contravene the constitutional provision because it is of a character appropriate to the emergency and allowed upon what are said to be reasonable conditions.")

The law at issue in *Blaisdell* was similar to HAMP in that it was justified as an emergency measure. But that is where the similarities largely end. In *Blaisdell*, the effective date of the law was expressly tied to the period of emergency. See *Blaisdell*, 290 U.S. at 416 ("The act is to remain in effect 'only during the continuance of the emergency and in no event beyond May 1, 1935.'") In contrast, the HAMP program has continued far beyond the period of economic emergency that justified its creation. The law in *Blaisdell* also did not seek to permanently change or alter the terms of the mortgage contracts themselves. Most important, the Minnesota statute in *Blaisdell* accounted for the impairment of contractual rights occasioned by its implementation by providing that the lender was entitled to receive the reasonable value of the income from the property during the time that the redemption period was extended. While HAMP purports to account for investor financial considerations (through "net present value" calculations) and provides modest financial incentives to servicers who complete modified loans, mortgage holders are not compensated for the reasonable value of the property while borrowers are evaluated under the HAMP program. Rather, any amount paid by the borrower is based on what the borrower is able to pay.

Emergency Measures Become the "New Normal"

As HAMP and other loss mitigation measures have become more common, state and federal regulators have sought to reinforce these practices through laws and regulations that make exercise of traditional foreclosure rights contingent on offering and exhausting all available loss mitigation options. While no law has gone so far as to independently require modification of loans, these laws and regulations have created an expectation in borrowers of a right to loss mitigation that is often at odds with their actual rights under the mortgage.

An example is the 2013 amendment to the Minnesota foreclosure statutes, Minnesota Statute § 582.043 (Loss Mitigation; Mortgage Foreclosure Dual Tracking), which imposes an affirmative duty on the loan servicer to notify a borrower in writing of "available loss mitigation options offered by the servicer that are applicable to the mortgagor's loan." Minn. Stat. § 582.043, subd. 5(1). If the mortgagor is eligible for a loan modification program, the statute provides that the servicer must timely offer the mortgagor a loan modification. If the mortgagor is not eligible for a loan modification, the law requires the servicer to offer any other available "loss mitigation option" for which the mortgagor qualifies. *Id.* at subd. 5(4). "Loss mitigation option" is broadly defined to include temporary or permanent loan modifications, forbearance agreements, repayment agreements, principal reduction, capitalization of arrears, and "any other relief, intended to allow a mortgagor to retain ownership of the property." *Id.*

The Minnesota statute also prohibits "dual tracking" of loss mitigation and foreclosure activities in connection with a loan. Specifically, the statute imposes a temporary moratorium tied to receipt of a loss mitigation application from the borrower during which a servicer may not move forward with foreclosure.

Other states have adopted similar requirements. Massachusetts amended its foreclosure law in 2010 to extend the 90-day right to cure period to 150 days, but to allow foreclosure after 90 days upon certification of good faith efforts to negotiate a commercially reasonable alternative to foreclosure. Mass. Gen. Laws c. 244, § 35A (2010). In Maryland, a bank must provide a borrower with a Notice of Intent ("NOI") 45 days prior to commencing a foreclosure action. Md. Code, Real Prop. § 7-105.1 (2016). The NOI must be accompanied by a loss mitigation application, information about loss mitigation programs, contact information for the servicer, information about housing counseling, and an application for mediation. *Id.*

The statutes generally make clear that they do not require servicers to provide mortgagors with any specific loan modification option. See e.g. Minn. Stat. § 582.043, subd. 2. These statements exist to avoid claims that the statute impairs the contract rights of lenders in violation of the contracts clause of the United States and state constitutions. However, in practice between the uncertainties surrounding the standards for compliance and the ability of borrowers to exploit the process through well-timed or repeated requests for assistance and challenges to the decisions made, the risk of delayed enforcement and impairment of contractual remedies is undeniable.

Enter the CFPB

At the same time states were enacting loss mitigation requirements, the federal government under the auspices of the Consumer Federal Protection Bureau (CFPB) was developing its own set of regulations intended to preserve and enhance the foreclosure avoidance and loss mitigation practices that HAMP started. CFPB's original proposed rules included a controversial provision that prohibited a servicer from making the "first notice or filing" required by applicable law for any judicial or non-judicial foreclosure process unless a borrower's mortgage loan is more than 120 days delinquent (the "120-day rule"). The stated objective of the 120-day rule was to assure that borrowers have an opportunity to be evaluated for loss mitigation options that the lender provides (if any) and to reduce borrower confusion about when foreclosure may begin. However, as the banking industry noted, in many instances, the 120 day rule worked at cross-purposes to the goal of early intervention by delaying the receipt of loss mitigation information required as part of a "first notice or filing" under state foreclosure laws.

More concerning, the 120-day rule threatened to significantly extend the foreclosure timeline. The banking industry noted that in Massachusetts the combined effect of state and federal rules would mean that foreclosure could not begin until a borrower is 270 days (9 months) delinquent; in New York, the loan would have to be in default for 210 days (7 months) before foreclosure commences; in Maryland, a bank could not initiate foreclosure until the loan is 165 days delinquent (approximately 5½ months). *See* American Bankers Association comments on proposed amendments to CFPB mortgage servicing rules, dated July 22, 2013. These dates do not take into account the impact of extended mediation processes required in some states, which can become protracted and further delay the commencement of foreclosure. The impact of these delays in accessing the collateral securing non-performing loans can be significant.

Crossing the Contractual Rubicon – Private Rights to Enforce HAMP

Another way in which state actions have altered the traditional contractual relationship between mortgage holder and borrower is through the creation of private rights of action. HAMP itself does not authorize a private right of action by borrowers to sue to enforce the Program's requirements. However, some states have recognized separate state law causes of action premised on obligations arising under HAMP, that threaten to fundamentally alter the contractual underpinnings of HAMP and the creditor-debtor relationship.

The most extreme example of this is the Minnesota mortgage servicer licensing statute, which, through the addition of a private right of action in 2007, was found to confer standing on an individual borrower to sue a servicer for failure to perform in conformance with its servicer participation agreement with the federal government. *Gretsch v. Vantium Capital, Inc.,* 846 N.W.2d 424, 431 (Minn.), *reh'g denied* (May 30, 2014), *cert. denied,* 135 S. Ct. 879, 190 L. Ed. 2d 705 (2014). The Minnesota Supreme Court recognized that contract law generally prohibits a third-party from suing to enforce contracts to which they are not a party, but found that an intent to abrogate such law was reasonably implied from the legislature's creation of a private right of action in favor of borrowers.

The Minnesota Supreme Court rationalized the contractual implications of its ruling by suggesting that the parties were aware of the rights afforded under the Minnesota statute when they entered into the servicer participation agreement. On petition for rehearing, the servicer responded to this reasoning, noting that servicers entered into the HAMP program understanding that participation would not expose them to private enforcement actions by borrowers and investors. While the servicer participation agreement contains general language stating that the parties agree to comply with federal and state law, it was noted that such language could not be reasonably understood to put servicers on notice that Minnesota law would allow non-party borrowers to sue to enforce the terms of the agreement when the agreement itself disclaimed such rights and no court had ever recognized such a right. Such reasoning, it was argued, was the proverbial "elephant in a mouse hole."

To this day, Minnesota stands alone as the only state in the country that has crossed the Rubicon of contractual privity and authorized borrowers to sue to enforce servicer participation agreements and, by extension, a servicer's compliance with HAMP. Under this theory, any number of unspecified written agreements that servicers have with

third-parties could potentially become the basis for a claim by a borrower. *See*, *e.g.*, *JP Morgan Chase Bank, Nat'l Ass'n v. Ackley*, 834 N.W.2d 82 (Table), 2013 WL 1749783 (Iowa App. 2013) (rejecting borrower attempt to enforce terms of National Mortgage Settlement.)

What Does the Future Hold?

With the expiration of HAMP later this year, the primary source of loan modification obligations that many state and federal laws seek to guarantee to borrowers will be lost. While loss mitigation will continue to be a required element of servicing for loans owned or guaranteed by Fannie Mae, FHA and other government sponsored entities, the future of loss mitigation options for privately-owned loans is less certain. Big banks will continue to operate loss mitigation/loan modification programs pursuant to the terms of national settlements and consent decrees. Banking regulators will press banks to continue such programs permanently and banks will likely agree where a financial case for continuing them can be made. For smaller privately owned portfolios, the availability of loss mitigation options will vary from owner to owner and based on the status of the loan.

While some states have repealed the emergency measures tying foreclosure remedies to loss mitigation in recent years (see, e.g. Mass. Gen. Laws c. 244, § 35A (2016)), it is unlikely that such measures will receded completely. In allowing the torch to pass from HAMP to CFPB, the federal government has arguably moved away from the original constitutional basis for imposing loss mitigation obligations on servicers, and moved increasingly closer to permanent regulatory interference with contract. But, so long as CFPB rules continue to be premised on loss mitigation options that the owner or assignee of a mortgage loan chooses to make available to borrowers, and do not create an independent right to a loan modification, they will not likely constitute an unconstitutional impairment of contract.

What is clear is that whatever path a bank or servicer chooses to follow in the future, the criteria to qualify for the loss mitigation options it chooses to offer will need to be clear and well-documented to be in position to establish compliance under the state and federal laws governing loss mitigation.

Michael Steinlage
Larson · King, LLP
(651) 312-6520
msteinlage@larsonking.com.