Insight

The CARES Act and Mortgage Servicers

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Executive Summary

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act provides substantial relief in the form of up to a year of forbearance to homeowners with mortgages backed by federal loans.
- The Act, however, does not expressly provide for mortgage servicers, who stand to suffer a liquidity shortfall of as much as $100 billion due to this forbearance.
- The resulting strain on the housing market could have immediate impacts on mortgage availability and price, and the ramifications for the broader economy could equal or exceed the stresses of the 2007-2008 financial crisis.

Introduction

In the face of the economic and social disruption caused by the coronavirus, Congress has enacted three stimulus packages. With an estimated $2 trillion price tag, the third package, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, is perhaps the largest and most significant stimulus package in U.S. history.

The final iteration of the CARES Act includes several provisions designed to provide a reprieve to homeowners. Most notably, the bill provides significant relief to holders of mortgages backed by federal loans in the form of six months to a year of forbearance and immunity from eviction or fees relating to late rent payments. Absent from the CARES Act, however, is consideration of the loan servicers themselves, who stand to suffer a six-month income shortfall of their entire federal loan portfolio.

This piece provides an introduction to mortgage servicing, discusses the provisions in the

CARES Act, and looks at what is and is not being done to shore up mortgage servicers and by extension the housing market.

An Introduction to Mortgage Servicing

A mortgage lender is a bank or other financial services company that provides borrowers (residential or commercial) with the funds to purchase a property. For the life of the loan a borrower will owe the mortgage lender the full amount borrowed plus interest, which the borrower will slowly pay off in monthly installments. In the strictest sense, a mortgage servicer is a third party that a mortgage lender will contract with to handle the processing of the loan, which includes, for example, tracking loan payments, calculating variable interest, and filing foreclosure notices in the event of default. In practice, however, this distinction quickly becomes muddied, as mortgage lenders often also act as mortgage servicers, and often in providing their services a mortgage servicer will actually buy the loan from a mortgage lender. Typically, a lender will sell a mortgage to a servicer so that the lender can continue to originate new mortgages, which is often more lucrative than servicing existing mortgages.

To complete the life cycle, mortgage loans are bought and sold on the secondary market, and a significant proportion of loans are bought by government sponsored entities (GSEs) Fannie Mae and Freddie Mac, which bundle these loans into a collection of securities known as mortgage-backed securities (MBS).

Housing Implications of the CARES Act

The primary focus of Title IV of the CARES Act is that it authorizes the Treasury to make $500 billion in loans directly to businesses impacted by the coronavirus (for a deeper analysis of the Act's implications for financial services, see here). Also included in the Title, however, are a number of seemingly disparate sections with a much wider focus, ranging from reforming the governance of Federal Reserve meetings to making it easier for banks to restructure troubled debt. This Title has three sections with implications for the housing market (for a deeper analysis of the Act's implications for housing, see here).

Most notably, the CARES Act provides that single-family and multifamily homes that are backed by a federal mortgage loan may request forbearance of up to a year. Any borrower experiencing direct or indirect financial hardship relating to the coronavirus is able to request 180 days forbearance, regardless of delinquency status. This period can be extended another 180 days at the request of the borrower. During this period of forbearance, no fees or interest will be applied to the borrower.

Servicers of federally backed mortgage loans cannot initiate foreclosure proceedings or foreclosure-related evictions for at least 60 days beginning March 18, 2020. For 120 days from the enactment of the Act (March 27, 2020), lessors of all properties backed by federal mortgage loans can neither evict tenants nor charge fees or penalties for the nonpayment of rent.

Implications for Mortgage Servicers

The Conference of State Bank Supervisors estimates that between one quarter and one half of all borrowers will be able to apply to their servicers requesting forbearance on payments. According to the Urban Institute, this number is higher, with federally backed mortgages comprising 62 percent of all first lien mortgages. The Mortgage Bankers Association noted that if one-quarter of borrowers avail themselves of forbearance for six months or longer, advancing demands on servicers could exceed $75 billion and could climb well above $100 billion. Although there is no evidence that the mortgage-service industry is undercapitalized, the immediate impact of such a significant income shortfall would likely render most if not all mortgage servicing firms at risk of collapse.

The effective demise of the mortgage-service industry would have extraordinary implications for the broader housing market and the economy as a whole. Immediately, mortgage lenders and large banks would not have a market for the mortgages they originate, requiring that they keep hold of these mortgages. This requirement would have an instantaneous impact on the pricing and availability of new mortgages. Without companies servicing existing mortgages, no mortgage payments could be collected and provided to investors. Pension funds would take an enormous blow, and economic recovery would necessarily be lengthened.

Relief for Mortgage Servicers

Although the CARES Act does not specifically provide for mortgage servicers, some relief has already been made available, most notably by the federal government agency Ginnie Mae. On March 27, Ginnie Mae announced that it would be implementing a system whereby mortgage servicers will be able to apply for advances in order to make scheduled payments to investors using a Ginnie Mae program normally employed in the wake of natural disasters.

This action, while a welcomed and necessary first step, may not go far enough, with many commentators calling for the Federal Reserve to establish an emergency lending facility for mortgage servicers. The Fed's response to the challenges posed by coronavirus has been swift and decisive, with the establishment of six new emergency lending facilities within the last few weeks. The creation of a lending facility designed to support mortgage servicers seems to many like the necessary next step, yet, to date the Fed has been quiet on the subject.

Conclusions

The potential scale of the problem has not gone unnoticed, with Treasury Secretary Steven Mnuchin announcing the creation of a taskforce within the Financial Stability Oversight Council (FSOC) to monitor nonbank mortgage servicers, suggesting that widespread liquidity challenges in the industry could cause a systemic threat to the economy.

It can be expected that mortgage servicers will be able to apply for relief either under the $349 billion being made available to the Small Business Administration or the $425 billion in loans and investments available to the Treasury Secretary under the CARES Act. But unlike other industries – most notably airlines, which receive direct support under the CARES Act – the lack of specific support for mortgage servicers is troubling given that the mortgage-service industry underpins the housing market. Bankrupting mortgage servicers, who are required to continue paying their investors and insurers regardless of whether their borrowers make payments, could create a liquidity strain in the housing market reminiscent, or exceeding, the challenges of the 2007-2008 financial crisis.