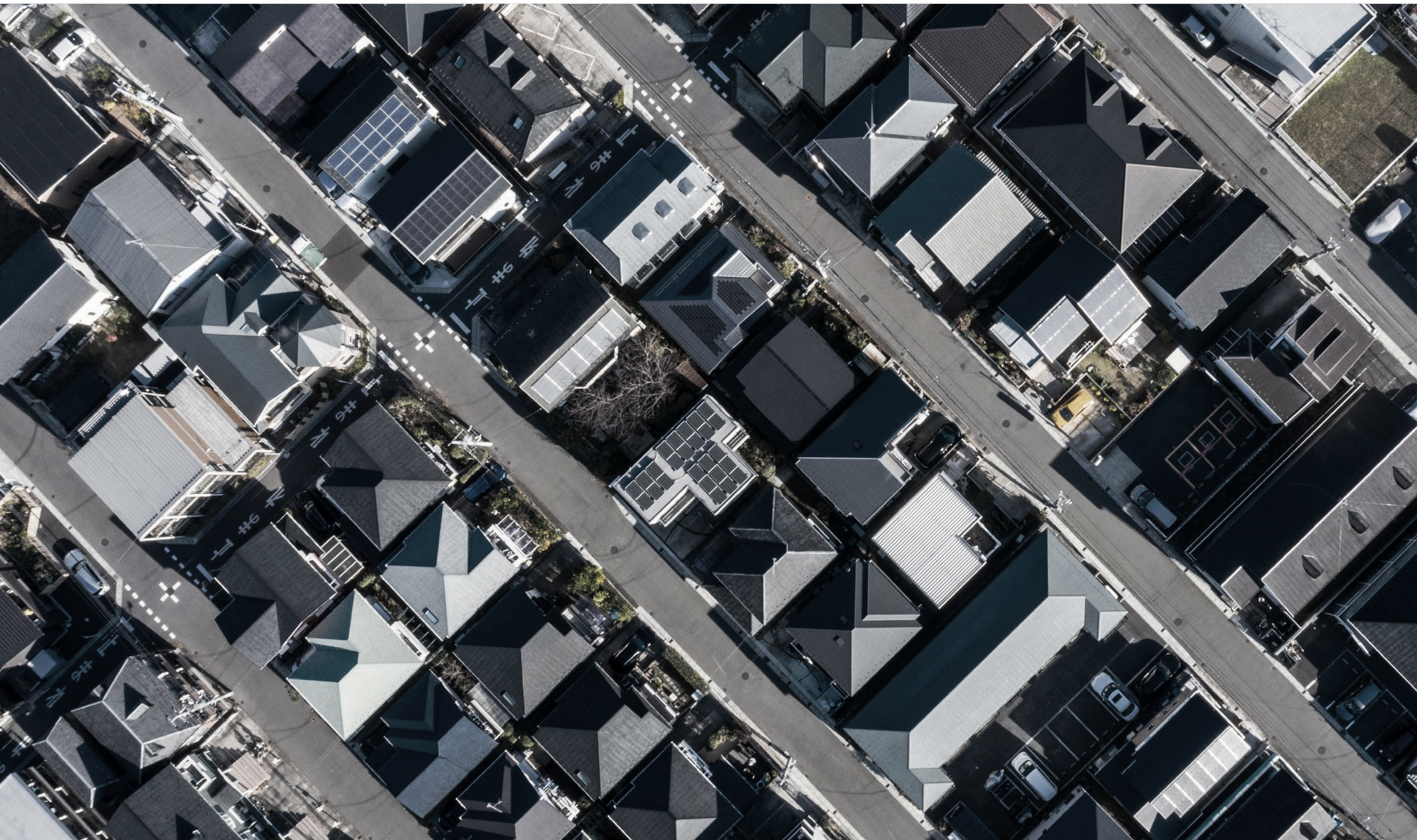
CARES ACT AND THE FUTURE OF MORTGAGE FORBEARANCE:

THE PATH FORWARD



INTRODUCTION

Banks and mortgage servicers were largely caught off guard by the COVID-19 pandemic, and had to scramble to respond to the crisis and resulting legislation. Nowhere is this more apparent than in home lending, where many borrowers faced economic hardship and needed help paying their bills. Following the passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, many borrowers took advantage of the expanded opportunity to utilize forbearance to stay in their homes.

Banks were overwhelmed by the deluge of forbearance requests early in 2020 and the abrupt transition to remote work for their entire workforce. They found themselves short-staffed, using inefficient, ad-hoc systems, and without processes in place to handle the changing environment.

As the landscape for 2021 and 2022 is becoming clearer, now is the time for banks to invest in a strategic plan to determine how to proceed with loans in forbearance and the best way to effectively service them.

IMPACT OF THE CARES ACT

A key provision of the CARES Act requires servicers of government-backed mortgage loans to grant forbearance to borrowers, suspending or reducing payments for up to 180 days. Should the borrower request an extension of the mortgage forbearance, the initial period must be extended up to another 180 days. The forbearance protections of the CARES Act were recently expanded, allowing borrowers to request up to two additional three-month extensions, up to a maximum of 18 months of total forbearance[1]. Servicers are prohibited from assessing fees, penalties, or extra interest during the forbearance period[2].

While mortgages are in forbearance, mortgage servicers are still required to continue paying their investors and insurers. This caused widespread concern and liquidity challenges throughout the mortgage servicing industry. The Federal Housing Finance Agency (FHFA) provided some relief to mortgage servicers by limiting the number of payments they are required to make. Servicers were expecting more assistance, and they've received it. Under the new policy, they are only required to advance four months of missed payments for loans in forbearance[3].

2020 Forbearance Requests

Recent data demonstrates that the CARES Act was successful in migrating delinquent borrowers to the forbearance option. The Mortgage Bankers Association (MBA) estimates that 2.6 million homeowners are in forbearance plans[4]. While there was an initial flood of forbearance requests, the share of servicers' portfolios in forbearance fell to 5.14% as of March 7, 2021.

A large portion of eligible borrowers in financial distress are taking advantage of the program and are extending their forbearances: 14.6% of total loans in forbearance are in the initial forbearance plan stage, 82.8% are in a forbearance extension, and 2.6% are forbearance re-entries[5]. Those loans in forbearance share many characteristics with loans associated with high default rates: high loan-to-value (LTV) ratios, low credit scores, and high debt-to-income (DTI) ratios[6].

As borrowers conclude their forbearance periods – either by voluntarily exiting or reaching the termination date of the forbearance – mortgage servicers are faced with the challenge of how to resolve the delinquency that accumulated during the forbearance period. To further complicate matters, there are approximately one million homeowners that either did not qualify for forbearance under the CARES Act – it only applied to borrowers with federally-backed mortgages – or failed to take advantage of the program[7]. Mortgage servicers will have several loss mitigation options; however, the prevalence of these options will likely differ from loss mitigation efforts during the Great Recession from 2007 - 2009, such as the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP).

1. https://www.consumerfinance.gov/coronavirus/mortgage-and-housing-assistance/mortgage-relief/
2. ABA Detailed Summary of the CARES Act
3. https://www.housingwire.com/articles/fannie-mae-freddie-mac-will-only-require-servicers-to-advance-4-months-of-payments-on-loans-in-forbearance/
4. https://newslink.mba.org/mba-newslinks/2021/march/mba-newslink-tuesday-mar-16-2021/mba-share-of-mortgage-loans-in-forbearance-decreases-to-5-14/?utm_campaign=MBA%20NewsLink%20Tuesday%20Mar.%2016%202021&utm_medium=email&utm_source=Eloqua
5. https://newslink.mba.org/servicing-newslink/2021/march/mba-servicing-newslink-tuesday-mar-9-2021/mba-share-of-mortgage-loans-in-forbearance-decreases-to-5-20/?utm_campaign=MBA%20Servicing%20NewsLink%20Tuesday%20Mar.%209%202021&utm_medium=email&utm_source=Eloqua
6. http://www.freddiemac.com/research/insight/20201117_mortgage_forbearance_rate_during_COVID-19.page?
7. https://www.wsj.com/articles/a-million-mortgage-borrowers-fall-through-covid-19-safety-net-11600335001

Differences between 2020 and 2008

The Great Recession was a housing-induced crisis. A decline in home prices in 2008 combined with the preceding years' loose underwriting guidelines resulted in many borrowers having negative equity. Some borrowers were unable to make payments or sell their house for enough to cover their mortgage, and others chose to strategically default. Short sales were prevalent, which was beneficial to services and investors, but not to borrowers, who were unable to take advantage of extended foreclosure timelines to remain in their homes. HAMP, HARP, and other programs were introduced to facilitate standard approaches to modifications for those borrowers with an ability to restructure their payments.

In stark contrast to 2008, the volatile and unpredictable economy stemming from the COVID crisis has produced the strongest housing market in more than a decade – and it could get even stronger. With home prices and resulting equity remaining high, borrowers have more incentive to maintain their homes in 2021. For borrowers whose reduced income can support the revised terms, a loan modification may be the optimal outcome for the borrower and servicer. Borrowers without income will likely want to sell their property, especially if they have significant equity. Alternatively, if they do not have much equity in their property, they will most likely aim for an extended foreclosure period. In these cases, a deed in lieu may be the best option for servicers and investors, while a short sale would be preferable to an extended foreclosure period.

8. https://newslink.mba.org/mba-newslinks/2020/november/mba-upward-revisions-to-2020-2021-mortgage-forecasts/; https://newslink.mba.org/mba-newslinks/2020/november/october-existing-home-sales-stay-strong/

FINDING THE RIGHT SOLUTIONS

The best outcome for both a servicer and a borrower is for the borrower to stay in his or her home. Unfortunately, that's not always an option.

To determine the best solution, a servicer must accurately understand and segment borrowers into these three profiles:

1. Borrowers that may be able to successfully come out of forbearance

2. Borrowers that may be able to qualify for a loan modification

3. Borrowers that will simply not be able to pay, necessitating a sale or foreclosure

Once the borrowers have been segmented into one of the three profiles, servicers can set up a forbearance analytics system to improve visibility into their portfolios and identify the next best steps for the different classification of borrowers. This data allows servicers to better forecast their portfolios net present value as well as their profit and loss, reducing the risk of running into a liquidity crunch. Updated forecasting must incorporate risks relating to extended loan modification negotiations and a potential raise in legal expenses due to foreclosures and bankruptcies.

In addition to determining how to proceed with loans in forbearance, mortgage servicers continue to face an influx of demand for customer service from borrowers who are considering or going into forbearance, or applying for loss mitigation. The spike in customer communication that accompanied the initial forbearance requests in the spring of 2020 will result in a corresponding wave of customers requesting loss mitigation as forbearances come to an end. Don't just throw resources and bodies at the issue. Automate the new processes and product offerings adopted in response to the crisis. It's the most efficient way to navigate through the coming wave of loss mitigation requests.

CONCLUSION

COVID has brought sustained uncertainty to housing economics, and while the initial government response has reduced the negative impacts, mortgage servicers and investors need to prepare for the expected spike in demand for customer service as borrowers exit forbearance. The path forward includes segmenting borrower profiles, building forbearance analytics systems, automating new process, and identifying and developing strategies for borrowers who may qualify for various loss mitigation options, and mitigating potential litigation liability.

AUTHORS

Tom Scott, Principal Consultant
Tom.Scott@capco.com

Zachary Ross, Senior Consultant
Zachary.Ross@capco.com

Charlie Vidal, Consultant
Charlie.Vidal@capco.com

CONTACT

Erik Johnson, Principal Consultant
Erik.Johnson@Capco.com

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

To learn more, visit our web site at **www.capco.com**, or follow us on Twitter, Facebook, YouTube, LinkedIn and Instagram.

WORLDWIDE OFFICES

APAC
Bangalore
Bangkok
Gurgaon
Hong Kong
Kuala Lumpur
Mumbai
Pune
Singapore

EUROPE
Berlin
Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
London
Munich
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA
Charlotte
Chicago
Dallas
Hartford
Houston
New York
Orlando
Toronto
Tysons Corner
Washington, DC

SOUTH AMERICA
São Paulo

WWW.CAPCO.COM

CAPCO

JN_2956