

Mortgage Servicing in the Time of COVID-19

Article By:

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The announcement last week by Freddie Mac, Fannie Mae and other agencies that they will provide mortgage loan forbearance arrangements for up to 6 months, subject to an extension of an additional 6 months, directly impacts mortgage servicers in two significant respects. First, mortgage servicers have to quickly pivot from a stable mortgage servicing environment to a servicing environment requiring a huge influx of financial resources and people necessary to service a potentially massive number of borrower's requiring forbearance, loss mitigation and other disaster relief measures. Second, although there is a forbearance arrangement in place with a borrower, the mortgage servicer is still responsible for advancing monthly principal and interest payments to investors, and advancing amounts to pay for property taxes and insurance premiums when they remain unpaid by the borrower.

In order to have the liquidity necessary to fund advances, mortgage servicers typically maintain warehouse lines of credit with their lenders. Under a warehouse line, the mortgage servicer uses the servicing fees it will collect for servicing mortgage loans as collateral for the loan. As advance requirements spike in the coming weeks and months, mortgage servicers will have to draw on such warehouse lines. At the same time, the amount available under such warehouse line may be negatively impacted by (i) mortgage refinancing, which results in prepayment of the related mortgage loan and write-off of the associated mortgage servicing asset and (ii) the requirement found in most warehouse lines requiring revaluation of the mortgage servicing assets based on the then-current market values, typically being calculated at the end of each fiscal quarter end. The net result is that the warehouse lines may not provide sufficient liquidity to allow mortgage servicers to deal with the increased advance demands and also cover the increased servicing costs associated with forbearance plans and other disaster relief measures.

Policy makers are being urged to provide the necessary liquidity backstops to mortgage servicers as part of the third federal stimulus package related to the Coronavirus. Injecting liquidity into the financial system directly through mortgage servicers makes a lot of sense. It allows the mortgage servicers to function without fear of illiquidity and it directly benefits the borrower and maintains the condition of the related property. These funds can be offered at the same 25 basis-point rate the Fed is now charging banks for discount-window access.

Another source of liquidity could come directly from the warehouse line lenders. Last week, the Federal Reserve and the FDIC issued guidance urging their lenders to provide some forbearance to their borrowers, which would include mortgage servicer warehouse borrowers. The MBA also

reported on March 19 that it is pushing for a 50% reduction in the lenders' capital requirements for loans like the mortgage servicer warehouse lines that are secured by agency mortgages and mortgaged-backed securities.

The swift action taken by Freddie Mac, Fannie Mae and other agencies to roll-out forbearance and other disaster relief policies for borrowers underscores the importance of a fully functioning mortgage market in the face of the COVID-19 pandemic. The regulators should follow suit and quickly take appropriate steps to provide the liquidity the mortgage servicers need to do their jobs.

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