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## Consumer Corner II

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### Will Courts Be Ready When Home Foreclosure Moratoriums End?



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The federal government and housing lenders have taken dramatic measures to help U.S. homeowners stay in their homes despite the economic crisis resulting from the COVID-19 pandemic. However, as these protections expire, millions of Americans may still be unable to repay their mortgages. Many of them are expected to file for bankruptcy to seek assistance. In fact, research indicates that chapter 13 has been traditionally used as a “save-your-home procedure,”<sup>1</sup> which could result in a tsunami of bankruptcy filings causing a surge of court hearings and delays associated with the home mortgage-modification process.

Within the legal community, this may raise the question as to whether U.S. bankruptcy courts are ready to manage the expected onslaught of home mortgage modifications and court proceedings that would come with it, as well as why it is appropriate for these courts to become involved in the mortgage-modification process. This article examines these questions from various perspectives, not only with a focus on the potential challenges that may lie ahead, but with a closer look at strategies and technology-enabled solutions to help avoid delays, backlogs and inefficiencies.

#### The Role of Bankruptcy Courts in the Mortgage-Modification Process

The legal authority of bankruptcy courts to create mortgage-modification programs was established more than a decade ago in *In re Alberto G. Sosa*.<sup>2</sup> With this decision, upholding Rhode Island's loss-mitigation program, the court found that the state's bankruptcy loss-mitigation program was consistent with the court's powers under the

Bankruptcy Code, which found that loss-mitigation programs are “a case-management tool designed to encourage the resolution of differences between residential mortgage lenders and their borrowers, and to provide a way for them to access the various federal housing programs available outside of bankruptcy ... [and] is intended to start a dialogue, giving the parties nothing more than the opportunity to discuss their respective positions.”

Since this decision, more than 25 bankruptcy courts across the nation have adopted similar programs to help facilitate the resolution of mortgage debt for distressed homeowners and debtors undergoing bankruptcy. Almost all of these court programs have required the use of a portal to facilitate the communication and document exchanges that are integral to the mortgage-modification process. In reviewing these programs, courts are not promoting a single solution but rather are simply defining program rules that have been proven to work. For example, the U.S. Bankruptcy Court for the Western District of Pennsylvania lists its approved portal vendors directly on its website<sup>3</sup> and provides an application that any portal vendor can complete and submit to the court for review and approval.

It is also important to highlight that mortgage-modification programs impose no requirement to reach any resolution, nor do they provide any rights or remedies not otherwise available to debtors. These programs do not dictate any specific result; they simply facilitate an orderly and transparent discussion between the parties in an attempt to resolve the mortgage default, which can otherwise be very difficult to do in general and in bankruptcy in particular.

1 Michelle J. White & Ning Zhu, “Saving Your Home in Chapter 13 Bankruptcy,” Nat'l Bureau of Econ. Research (July 2008).

2 *In re Alberto G. Sosa*, No. 10-11702 (Bankr. D.R.I.).

3 See “List of Approved LMP Document Preparation Software and Portal Providers,” U.S. Bankruptcy Court (W.D. Pa.), available at [www.pawb.uscourts.gov/list-approved-lmp-document-preparation-software-and-portal-providers](http://www.pawb.uscourts.gov/list-approved-lmp-document-preparation-software-and-portal-providers) (unless otherwise specified, all links in this article were last visited on Nov. 22, 2021).

## The Evolution of Home Mortgage-Modification Programs

Court-based home mortgage-modification programs first emerged in the years following the mortgage crisis that resulted from the Great Recession of 2008. They were adopted to help distressed homeowners manage their home mortgage debt within the court system. These programs are designed to facilitate the process by providing basic procedural guidelines and simple tools for both borrowers and creditors that can be accessed by either party at any time with only an internet connection. As a result, all parties involved in the home mortgage-modification process are aligned and held accountable to move the process forward. By providing structure and transparency to the process, these courts have leveraged the bankruptcy process to enable debtors and creditors to reach mutually consensual resolutions with minimal court time or resources.

While it may seem counterintuitive because they represent clients with different interests, debtor and creditor attorneys also share a mutual benefit in seeing distressed homeowners successfully complete their home mortgage modifications. Both greatly benefit from a more collaborative process that more effectively and efficiently delivers answers on behalf of their respective clients. As one servicer put it when discussing the adoption of these programs, it “would save all of us time and money.”

To keep pace with the volume of home mortgage-modification requests that are expected in the coming months, bankruptcy courts that have not yet acted to implement these programs have the opportunity to prepare. By taking the time now to adopt formal home mortgage-modification programs that facilitate real solutions for debtors and creditors, bankruptcy courts will be better prepared for the expected onslaught of new filings involving home mortgage debt.

## Benefits and Limitations of Chapter 13 in Managing Home Mortgage Modifications

Chapter 13 has been routinely used by debtors to avoid home foreclosures. In many ways, it is a borrower’s last hope. While a chapter 13 filing can be beneficial, there are limitations. First, it is already difficult enough for debtors to find and submit the right information to their mortgage-servicer. A bankruptcy filing only makes the process more difficult because many servicers are reluctant to speak to a debtor out of fear that they might be in violation of the automatic stay. Second, servicers may hesitate to speak to the debtor’s attorney unless they secure a written authorization from the debtor.

Further, by definition, a chapter 13 plan will result in higher payment for the debtor because the debtor will be required to pay the post-petition mortgage payment plus the pre-petition arrears. This increased mortgage payment might be an insurmountable problem because if the debtor could not afford the original mortgage payment, they are likely never going to be able to afford the original payment plus an additional amount to repay the arrears. This is completely counter to a mortgage modification, as the goal is to lower the total monthly mortgage obligation for the borrower.

As a result, chapter 13 filings have been limited in their ability to provide long-term solutions for debtors with mortgage issues. In fact, a study published in the *Harvard Law Review* found that approximately 75 percent of chapter 13 debtors with mortgage issues end up losing their homes to foreclosure within three years of seeking bankruptcy relief.<sup>4</sup> Another found the situation even more dire, concluding that “only about 1 percent of chapter 13 filers save their homes when they would otherwise have defaulted.”<sup>5</sup>

While a chapter 13 filing is a great tool to slow down a foreclosure, it is not a final solution. It is not enough to simply put a temporary stop to the foreclosure, because in the end all parties — the debtor and creditor alike — benefit from a mortgage modification. Debtors are able to keep their homes and avoid major disruptions to their lives, and creditors are able to convert nonperforming loans into performing ones. Furthermore, when mortgage modifications are successful, neighborhoods and society as a whole benefit by keeping communities intact and ensuring that the real estate market does not have to absorb major shocks like the Great Recession, or the next wave of foreclosures that many are predicting is coming in the wake of the COVID-19 pandemic with the end of the foreclosure moratorium.

## Potential Challenges Lie Ahead for Bankruptcy Courts

According to *Black Knight’s* June 2021 Mortgage Monitor, approximately 1.86 million homeowners are in active forbearance plans. The report estimates that 65 percent of all forbearance plans (which includes almost 80 percent of VA and Federal Housing Administration (FHA) loans in forbearance) — or a total of approximately 1.2 million — could expire before the end of the year.<sup>6</sup> Certain regions and demographics are facing greater challenges with more homeowners who are vulnerable to the end of mortgage-forbearance relief. In a recent study released by the American Enterprise Institute, the highest levels of FHA loans in distress were found to be in Atlanta, Houston and Chicago.<sup>7</sup> Moreover, these financial hardships are expected to be more prevalent in households of color, particularly Black and Latino households, where they will face disproportionately higher foreclosure rates, with about 17 percent of Black homeowners and 8 percent of Hispanic or Latino homeowners having reported missing a mortgage payment in May 2020, compared to about 4 percent of White homeowners.<sup>8</sup>

As a result, we can anticipate a steadily increasing and potentially overwhelming number of home mortgage issues affecting bankruptcy courts around the nation. In courts without a formal program in place to manage the process and hold each party accountable for their roles, any attempt at a home mortgage modification will likely result in a lengthy

4 Joshua Boehm, “Chapter 13 Debtors’ Home Loss in the Foreclosure Crisis,” *Harvard Bus. Law Rev.* (2013), Vol. 3 at 185.

5 See White & Zhu, *supra* n.1.

6 “June 2021 Mortgage Monitor,” *Black Knight* (Aug. 2, 2021), available at [blackknights-june-2021-mortgage-monitor](https://blackknights-june-2021-mortgage-monitor).

7 Jacob Passy, “Mortgage Forbearance Is About to End for Millions of Americans. Here’s Why That’s Good News for Home Buyers,” *MarketWatch* (Aug. 11, 2021), available at [marketwatch.com/story/mortgage-forbearance-is-about-to-end-for-millions-of-americans-heres-why-thats-good-news-for-home-buyers-11628609524](https://marketwatch.com/story/mortgage-forbearance-is-about-to-end-for-millions-of-americans-heres-why-thats-good-news-for-home-buyers-11628609524).

8 “A Looming Crisis: Black Communities at Greatest Risk of COVID-19 Foreclosure,” *Nat’l Consumer Law Ctr.* (July 2020), available at [nclc.org/images/pdf/special\\_projects/covid-19/IB\\_Covid\\_Black\\_Forbearance\\_Foreclosure.pdf](https://nclc.org/images/pdf/special_projects/covid-19/IB_Covid_Black_Forbearance_Foreclosure.pdf).

and laborious undertaking for all parties involved. Such a delay will cause backlogs, will be costly and will negatively impact bankruptcy courts. Worse yet, as other studies have shown, bankruptcy proceedings will ultimately have little to no impact on the debtor's ability to save their home or the creditor's ability to rehabilitate the loan.

## Strategies and Solutions to Minimize Backlogs and Delays

Bankruptcy courts have already established themselves as the venue where distressed consumers seek orderly resolution to economic hardships that have become untenable. Mortgages are far and away the largest consumer debt. Bankruptcy courts can offer real solutions by implementing formal programs that help the parties involved reach a decision. Some of the courts that already have programs have achieved successes — 70 percent approval rates and 100 percent decision rates in a fraction of the time that it normally takes to complete a mortgage modification outside of one of the established programs — all while increasing efficiency, reducing costs to all involved and having almost no impact on court resources.

These success rates are dramatically higher than when mortgage modifications are pursued outside of the bankruptcy court or outside of a structured program because of the mutual accountability between debtor and creditor that the court imposes and the efficiencies that the systematic approach yields. Most importantly, more than 500 mortgage-servicers nationwide already participate in these programs and help borrowers achieve these results. This large-scale integration and demonstrated past performance serve as a programmatic foundation for scale across all bankruptcy courts — a ready-to-deploy turnkey solution that is especially relevant today with the millions of homes that are in a state of significant delinquency and default.

Technology applications that often accompany court programs help the courts streamline the process with all the necessary documents and next steps in one centralized portal, giving access to all involved parties. As the courts have gradually adopted technology to manage other facets of judicial operations — ranging from PACER to electronic filing to Zoom calls — they can also benefit by embracing technology to solve the issues surrounding the home mortgage-modification process. The mortgage-modification portals could have the same impact as case management/electronic case filing (CM/ECF) when it was universally adopted. Before CM/ECF, attorneys and other parties did not have a centralized repository to find pleadings and other court documents. Today, these documents are readily available with online access, transforming how professionals and involved parties share case-specific information. These technological advances did not alter any rights; they simply made the bankruptcy process more efficient. Similarly, the adoption of online portals to manage the home mortgage-modification process could mirror this transformation.

Online web-based portals also resolve complicated communication issues by ensuring that debtors and creditors always have a secure and dedicated channel through which they can exchange messages and documents. The portals allow for complete transparency and documentation

processing between the parties. On average, it takes only five days to acknowledge receipt of a package, 48 days to report a complete file and 65 days to report a decision through these online mortgage-modification portals — results that far exceed average industry metrics for outside programs. Loan-servicers are also integrated within the system so that requirements are clear and borrowers know exactly what to submit.

To further the success of court-based programs and portals for mortgage modifications, bankruptcy courts should also provide training so that attorneys and their teams fully understand how they work and the benefits they can provide. These training sessions should be continued on a regular basis to ensure that the programs and solutions provided by the courts are widely and consistently used to help those who need them.

## Conclusion

In the wake of the COVID-19 pandemic, distressed homeowners across the nation are facing a difficult road ahead as forbearance and home mortgage moratoriums come to an end. By implementing court-adopted mortgage-modification programs, bankruptcy courts have the opportunity to make the home mortgage-modification process less painful, more streamlined, more efficient and more successful. While it might not be possible to avoid the increase in distressed homeowners seeking to resolve their home mortgage debt issues in the coming months, bankruptcy courts have a meaningful opportunity to help avert unnecessary delays brought about by the traditional mortgage-modification process. With advance planning and the implementation of mortgage-modification programs in jurisdictions across the nation, bankruptcy courts will be instrumental in managing the mortgage-modification process to ensure that it is more efficient, more effective, and potentially more successful in saving debtors' homes from foreclosure. **abi**

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