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Trends in Mortgage Lending for 2011

"I believe the exposure of the banks' questionable foreclosure practices will cause consumers to consider the legitimacy of their original mortgages."

By Christopher Brown Esq.

What trends will shape the picture of mortgage lending, mortgage foreclosure and mortgage investments in 2011? How will lenders and borrowers react in the next 12 months after a record number of U.S. homes went into foreclosure in 2010? I expect the most significant trend to be a dramatic shift in the nature of the relationship between borrowers and lenders.

Here are some of the other trends that I foresee shaping the mortgage sector in 2011:

Borrowers will look for ways to invalidate their mortgages

I believe the exposure of the banks' questionable foreclosure practices will cause consumers to consider the legitimacy of their original mortgages. We're expecting to see an increase in the number of borrowers asking about suing to declare their mortgages void because of issue of predatory lending or fraud. Because of the banks' well-publicized shady foreclosure practices like "robo-signing" and documentation issues, we foresee that consumers will say to themselves, "If the banks are flubbing documentation during foreclosures, maybe they flubbed the documentation when they originally made the loan." We're already seeing an increased interest in forensic audits to look into these issues. Consumers are hiring people to go back and look at original loan documents like the application, Good Faith Estimate (GFE) and HUD-1 Settlement Statement to see if there was any wrongdoing at that point. Consumers hope that these audits will show technical violations that could lead to their mortgages being declared void. This whole idea might be appealing to borrowers because if you take it to its theoretical conclusion, there's a potential that the loan could be void and you'd essentially get your house for free. But these suits are both time-consuming and expensive and the odds of winning are small.

Borrowers will stay in "foreclosure stalemate" longer than ever

Expect to see an increase in the number of homes in "foreclosure stalemate," where borrowers continue to live in homes without paying mortgages and banks continue muddying the workout process. Banks either have been dragging their heels in offering borrowers meaningful alternatives or are not offering programs that provide meaningful alternatives. They do not approve enough loan modifications or short sales and it takes them forever to make a decision—good or bad. The truth is that during the foreclosure process, banks want borrowers to think they want to take the houses, pushing them to find the money to bring the mortgage current. But everyone knows they really don't want the houses. I expect those borrowers' frustrations with the banks' so-called "loss mitigation programs" will boil over next year to the point where they'll just give up and tell the banks to take the homes. Borrowers will say, "You won't do a modification and you won't do anything to help me stay in the house, so here's the house." It's essentially calling the banks' bluff. When that happens, I predict that the banks will put the brakes on the foreclosure action and put borrowers into an ongoing foreclosure stalemate. The borrowers will continue to live in their houses, not paying their mortgages and not pursuing any foreclosure alternative. The banks won't push the foreclosure through to take title because they won't want the homes.

Borrowers will simply walk-away

The number of people walking away from their mortgages will continue to escalate in 2011. In the past, people believed they could find a way to work with the banks, but there's been enough publicity about this as a false hope that I forecast more people than ever will simply walk away from their homes. In the past,

people might just hang around in hopes of working things out. All the while, this foreclosure cloud would be hanging over them. But more and more people have been in this cloud for a long time and they just want to be done with it. Unlike a foreclosure stalemate, these people will leave their houses and find new places to live.

Fewer bank takeovers of homes

The housing marking has been slow to recover and banks no longer look to a time when it will improve. When the housing market first took a dive, banks had a better appetite for homes because they were expecting the market to recover and the assets to become valuable again, thus enabling them to recover the loan. But, the foreclosure crisis was broader and deeper than originally anticipated. Banks took title to properties in foreclosure and borrowers put their houses up for sale in order to avoid foreclosure. In the wake of the mortgage debacle, lenders were making fewer loans. This will lead to too many houses on the market for the number of available buyers. Because the housing market has been so slow to recover, I believe that banks will be saying it might be better to keep people in their homes to reduce the glut of homes for sale. With fewer houses on the market, prices will rise and they'll be more likely to recover more on the loan. It's simple economics: Reduce the supply and the prices will go up.

Changes in the servicer/investor dynamic

There is likely to be a change in servicer/investor dynamic in 2011 because investors are going to realize it's better for them in the long-run to stop putting pressure on the servicer to guess what's best for the investor. The investor is the company that owns the loans, but the investor doesn't deal with the borrowers or handle the day-to-day administration of the loans. Instead, the investor hires a servicer to do that and the contract between the investor and servicer usually obligates the servicer essentially to act in the investor's "best interests." As a result, when the loan gets in trouble, the servicer historically hasn't wanted to approve any loss mitigation alternative, like a loan modification or short sale, without the investor's approval. The reason for that is that the servicer didn't want the investor claiming the servicer's action wasn't in the investor's best interest. They could come back to the servicer and say, "You cost me money and now you need to pay me back out of your own pocket." Investors liked the possibility of a potentially solvent servicer paying an insolvent borrower's loan. Servicers are afraid of that, so they have been thinking the safest thing for them to do was to foreclose. This resolution, although it gets servicer off the hook, isn't the best solution for the investor. Investors now may be looking at the situation in a new light. I forecast that they'll change their tune. They'll begin to realize that it's better for them to approve modifications and short sales to keep people in their houses because I'd rather have less money coming in than take over a house I can't sell. Expect to see one of two things:

- More and more investors will approve loss mitigation proposals; or
- More and more investors will remove the specter of claims that the servicer didn't act in the investor's best interest.

In short, there will be more modifications and short sales approved because of this change in the servicer/investor dynamic.

Here's how I see the next 12 months: No one involved in the foreclosure crisis—not borrowers, lenders, nor servicers—has benefitted from the existing attempts to solve it. That means that everyone will be rethinking how they handle foreclosure. The focus will be shifting to what is best in long-run. Only time will tell whether the convergence of their differing views is a result that benefits everyone.

Christopher Brown Esq. is a partner in the Westport, Con. law firm of Begos Horgan & Brown LLP. He received national attention for his role in several ground-breaking foreclosure cases, in which he took on and beat the mortgage industry in foreclosure matters. He may be reached by phone at (203) 226-9990 or e-mail cgb@begoshorgan.com.