

SERVICING LOANS DURING THE COVID-19 OUTBREAK: WHAT PRIVATE LENDERS CAN AND CANNOT DO!

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For those of you who have been receiving our firm's daily COVID-19 updates, you know that there are new orders, rules and regulations coming out seemingly by the hour! Keeping track of all the information can feel mind-numbing and, then putting it into practice, can almost seem impossible. The purpose of this article is to take much of the information floating around and answer some of a private loan servicer's core questions: *Can we keep our doors open, charge late charges or default interest, initiate foreclosure, record a NOS, go to sale, evict the occupants post-foreclosure, etc.?*

A few important notes to keep in mind before proceeding:

1. Please keep in mind that new federal, state and local regulations are in the works. In fact, there is currently a bill pending with the California Legislature that would bar all foreclosures and evictions during the remaining period of any statewide or local state of emergency declaration. As a result, the information provided below is ever-changing. Before taking any of the actions discussed below, please reach out directly to our office or discuss with your own counsel.
2. The below analysis is intended for private lenders. Different rules apply to loans owned or insured by Fannie Mae, Freddie Mac, the Department of Housing and Urban Development ("HUD/FHA"), the Veterans Administration and the U.S. Department of Agriculture.
3. The article does not analyze every local ordinance. As a result, additional restrictions could apply in a particular County or City. Please consult counsel before proceeding with any action discussed herein.
4. Regardless of specific regulations, we expect Courts to look unfavorably on foreclosure efforts against those whose income was negatively affected or medical expenses substantially increased by COVID-19.

Are private lenders exempt from California's Stay at Home Order?

Likely. On March 19th, Governor Newsom issued a statewide Stay at Home Order. The Order requires "all individuals living in the State of California to stay home or at their place of residence **except as needed to maintain continuity of operations of the federal critical infrastructure sectors** as outlined at <https://www.cisa.gov/critical-infrastructure-sectors>. As of the date of the Order, federal critical infrastructure sectors included the Financial Services Sector, defined as "thousands of depository institutions, providers of investment products, insurance companies, **other credit and financing organizations and the providers of critical financial utilities and services that support these functions.**" [Emphasis added.] Moreover, on March 28, 2020, the CISA updated its guidance in the sector of "Financial Services" to include: the following:

- "Workers who are needed to provide, process and maintain systems for processing, verification, and recording of financial transactions and services, including payment, clearing, and settlement; wholesale funding; insurance services; **consumer and commercial lending**; and capital markets activities)."
- "Workers who are needed to provide business, commercial, and consumer access to bank and non-bank financial services and lending services, including ATMs, **lending and money transmission**, and to move currency, checks, securities, and payments (e.g., armored cash carriers)."

Amendments in "Other Community- or Government-Based Operations and Essential Functions" included the following:

- "Staff at government offices who perform title search, notary and recording services in support of mortgage and real estate services and transactions"

- **“Residential and commercial real estate services, including settlement services.”**

One could make a very good argument that private lenders and loan servicers, as well as the businesses that support them, fit under the above definitions included in the Financial Services Sector. *However, since the Governor’s order has not been tested, no one can be sure how a court would rule on the scope of the “financial services” exception.*

In addition, there are several county-specific Shelter in Place Orders that provide specific exemptions for operation of financial and legal services as essential businesses. But, again, the exceptions have not yet been tested or confirmed by a court.

Based on the above, it is our belief that companies like law firms, loan originators and servicers, foreclosure trustees, auction companies and auctioneers and the employees, contractors and vendors that carry out the statutory and necessary functions governing the creation, maintenance and enforcement of financial products like real property loans are essential businesses in the Financial Services Sector because they are “other credit and financing organizations . . . and services that support these functions” as defined in the Financial Services Sector by the Cybersecurity & Infrastructure Security Agency. But, again, nothing has been tested at this point so there is always some risk that a court could find otherwise.

One practice point worth mentioning – if you decide to rely on the financial services exceptions to any state or local stay at home orders, you may want to consider providing any employees who are coming to work with a letter that they can use to articulate why they are going to work, should they get stopped for any reason. While the CMA was asked to prepare a general letter to that effect, it is not practical since the landscape is constantly changing. That said, most CMA members can read the order and draft their own letters or consult with counsel.

Can a private lender charge late charges or default interest right now?

Yes, but.... Currently, there is no prohibition on private lenders charging late fees or default interest. However, doing so in today’s climate may be viewed negatively by a court. The Governor’s Press release dated March 25, 2020 announced that certain “financial institutions will waive or refund at least the following for customers who have requested assistance: Mortgage-related late fees...” In addition, the Department of Business Oversight (“DBO”) provided similar guidance to its licensees in correspondence issued that same day. While these communications did not comprise mandatory or statutory bans, they indicate recommendations by the Governor and the DBO, and would likely be cited in court by borrowers seeking to challenge the fees. In particular, we would be concerned with charging default interest on a borrower whose default was “caused” by COVID-19.

Can a private lender record a Notice of Default in California?

Yes. Loans owned by non-government and private investors are not subject to express governmental prohibitions regarding foreclosure at this time (the Governor’s Order is only a “request” and the DBO Letter is “guidance”) and can direct their own portfolios, even where the default was “caused” by COVID-19. However, consideration should be given to legitimate requests from borrowers for relief. That said, it may be difficult to determine the extent to which loan defaults and inability to pay or cure are “caused” by COVID-19, such that borrowers could challenge the validity of a Notice of Default and subsequent foreclosure on equitable grounds. Each loan should be evaluated on a case-by case basis to determine whether it is prudent to proceed. In addition, there may be other practical considerations, such as whether the title company will issue a Trustee Sale Guaranty (we have been told that some title companies are hesitant to issues TSGs given the limitations on County Recorder services).

Can a private lender record a Notice of Sale on a pre-existing default?

Yes. Because loans owned by non-government and private investors are not currently subject to express governmental prohibitions regarding foreclosure, there is no direct prohibition on recording Notices of Sale. In addition, since the Governor’s “request” and DBO’s “guidance” only related to defaults “caused” by COVID-19, one could argue that recording a Notice of Sale on a pre-COVID-19 default does not fall within the purview of the government’s recommendations. Nevertheless, there are several practical considerations. In light of the various Shelter in Place Orders in many local jurisdictions, it may be difficult for local vendors to complete the necessary

posting of the Notice of Sale on the subject property in those areas. Our firm has received reports of local sheriffs prohibiting private process servers and posting agents from completing service or postings in some areas. Moreover, based on media coverage of “moratoria,” borrowers may be under the mistaken impression that all foreclosure activity is banned, and it may be difficult to determine the extent to which loan defaults and inability to pay or cure the default is “caused” by COVID-19 impacts, such that borrowers could challenge the validity of a Notice of Sale and subsequent foreclosure on equitable grounds. Lastly, as explained below, a lender may be unable to complete the actual foreclosure sale. If one cannot complete the sale, then recording the Notice of Sale may be pointless.

For defaults arguably “caused” by COVID-19, there are no specific restrictions on recording notices of sale. As a result, the same analysis provided above applies (both as to the NOD and NOS). However, please keep in mind that recording the Notice of Sale on a virus-related default would be subject to even more scrutiny than proceeding on a non-COVID-related default.

Can a private lender proceed with the foreclosure sale?

Completion of a foreclosure sale with respect to private lenders (if the default was caused, or the cure of the default was prevented, by COVID-19-related issues) controverts the **intention** of the Governor’s Orders issued March 16 and 19, his March 25 Press Release and any local Shelter in Place Orders, even if the Orders are arguably not binding on the essential business operation of a private lender. In the current environment, a private lender should appreciate and evaluate the risk that a borrower may file litigation challenging the validity of a foreclosure sale conducted during the pendency of such orders. Theories could include, among others: (1) the sale was conducted in violation of the Governor’s Executive Order requesting foreclosure and eviction moratoria or the Governor’s Stay at Home Order; (2) COVID-19 caused or contributed to the Borrower’s inability to cure the default or payoff the loan; (3) the sale was conducted in violation of a local Shelter in Place Order prohibiting public gatherings in excess of the specified number of people; (4) the sale was invalid due to the restraint or lack of robust competitive bidding due to the foregoing Orders in violation of Civil Code section 2924h(g); (5) equitable arguments involving the borrower’s “reasonable” belief due to media coverage that no sale would occur under the circumstances. Even if the private lender ultimately prevails in the litigation, the delay and cost may not be worth the upside with going to sale.

Moreover, lenders may be unwillingly forced into the role of landlord if the eviction process cannot promptly be completed, as discussed in further detail below. Being unable to evict the occupants and sell the property could cause added financial concerns if the property is subject to a 1st lien! Thus, care should be taken in evaluating whether proceeding with a foreclosure sale in a particular jurisdiction is warranted in light of these risks. **In addition, even if a lender opts to proceed with the foreclosures sale, some foreclosure auctions are being prohibited by local law enforcement for violating maximum public meeting restrictions.**

Can a private lender proceed with a post-foreclosure eviction?

The post-foreclosure eviction process is likely the most impacted by the recent Stay at Home Order, Shelter in Place Orders, government moratoria and court closures.

The Governor’s March 16th Order requested a moratorium on foreclosures and related evictions where caused by COVID-related loss of income or increase in expenses. The Order also authorized local jurisdictions to take action to limit foreclosure and eviction activity as needed to address local COVID-19 impacts. At least 50 local jurisdictions have taken action to delay or prohibit evictions in some way, while few have expressly prohibited completion of foreclosures. Since the eviction process results in the displacement of persons from their homes, these jurisdictions have limited the availability of eviction judgments and the enforcement of writs of possession by sheriffs in light of the risk of exposing evicted tenants to COVID-19, which the Stay at Home Order and Shelter in Place Orders were principally designed to prevent. **Moreover, on March 27, 2020, the Governor subsequently issued an Executive Order banning the enforcement of eviction orders for renters affected by COVID-19 through May 31, 2020. The order prohibits landlords from evicting tenants for nonpayment of rent and prohibits enforcement of evictions by law enforcement or courts. It also requires tenants to declare in writing, no more than seven days after the rent comes due, that the tenant cannot pay all or part of their rent due to COVID-19. Even following the termination of this Order, process servers may face challenges serving the eviction complaint; courts may not be available for hearings; judges will be predisposed to ruling against**

evicting lenders; and some Sheriff offices are refusing to serve lockout notices or conduct lockouts based on remaining local orders.

In sum, while there is not currently a blanket prohibition on foreclosures in California, we strongly recommend consulting with counsel before recording a NOD, NOS, going to sale or considering an eviction.

As mentioned at the outset of this article, new regulations are coming out almost daily. Before taking any of the actions discussed above, please check all federal, state and local regulations or consult with counsel.

Thank you and if you have any questions regarding a particular loan, your servicing policies during these challenging times or would like to be added to our COVID-19 updates, please feel free to contact Robert Finlay at rfinlay@wrightlegal.net or Michelle Mierzwa at mmierzwa@wrightlegal.net.



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