

Mortgage Servicing News

OCTOBER 2012

For Residential and Commercial Servicers

Liability for Servicers: Localities Jump in Game

By Jonice Gray Tucker & Jeffrey Naimon

As if the federal-state settlement with the largest mortgage servicers didn't give the servicing industry enough to do, localities, including cities, towns and counties, are ratcheting up demands on all servicers in connection with the maintenance of foreclosed homes.

This trend ties in to the recent state and federal enforcement actions that, among other things, require servicers to supervise more closely their third-party vendors, including contractors, real estate brokers, and property maintenance vendors engaged by servicers to manage real estate owned properties.

For example, boarding up foreclosed homes and maintaining them in compliance with code standards is usually contracted to third-party vendors, and, as discussed in one of the author's recent article "Will Vendors Create New Liability for Servicers?" these contracts can create potential risk for the servicers involved.

Under the terms of the federal-state servicing settlement, the nation's largest servicers may be on the hook for ensuring their vendors' compliance with legal requirements during foreclosure. Further, the CFPB wants all servicers to conduct more extensive due diligence on their providers' compliance with law. With 50 million mortgage loans being serviced, this is a tall order, involving the application of complex and detailed legal requirements to what may previously have been thought of as straightforward fix-up work.

Foreclosure-related laws range from broadly applicable federal consumer protection laws, to state laws on notices and required documentation, to local ordinances creating an obligation to register foreclosed properties. Many of these foreclosure registration ordinances include provisions obligating the REO owner to ensure the foreclosed properties are building code-compliant.

As local building codes and registration requirements are non-uniform and proliferating, servicers should anticipate devoting more resources than ever to monitor their own and their vendors' compliance performance; and deployment of resources into third-party provider monitoring may not eliminate challenges from previously unlikely sources.

For example, the servicer of a mortgage on a foreclosed home with severe fire or flood damage may hire a contractor who decides to cover exposed areas with temporary cover. These materials may not comply with local building codes, or they may be left in place longer than allowed, leading code enforcement officials to cite the owner or mortgagee for a violation.

Along the same lines, building codes are usually specific about the requirements for swimming pool enclosures and balcony railings, but if these are destroyed or damaged by the former homeowners or by storm or accident, does the servicer's legal duty extend to monitoring his contractor's code compliance in performing repairs? These examples illustrate the potential for liability that may be thrust on servicers in connection with outsourced repair and maintenance tasks conducted during the foreclosure stage.

Localities appear to believe that by placing the cost of these new requirements on lienholders and loan servicers it somehow makes these repairs free, or at least free to the locality. While that may be true in the very short run, basically every

**Mortgage servicers
have been in the
regulatory and
enforcement crosshairs
for some time now.**

mortgage in the country includes covenants by the borrower to properly maintain their homes. If locality property preservation requirements continue to proliferate, servicers may begin to enforce these contractual covenants on performing borrowers who still have the financial resources to maintain and repair their properties to ensure that, at the very least, the properties are in good repair when the default begins.

As a result, the real cost of these repairs will be on the homeowners who have borrowed money secured by their properties, as opposed to the lenders that hold the lien.

Mortgage servicers have been in the regulatory and enforcement crosshairs for some time. The highly publicized settlement has drawn attention to some of the practical problems facing local communities as a result of high foreclosure levels. If local officials such as building code enforcers and local lawmakers turn up the pressure on the servicing industry in an attempt to increase the hands-on physical maintenance of REO properties, legal compliance

lapses by vendors may soon result in an emerging area of liability risk for the industry.

This further highlights the need for servicers to carefully select, monitor and evaluate their third-party vendors. ♦



Jonice Gray Tucker and Jeffrey Naimon are partners of BuckleySandler LLP, Washington.