

Podcast: *The Consumer Finance Podcast*

Episode: The Foreclosure Comeback: Residential and Commercial Risks for Lenders and Servicers

Host: Chris Willis

Guests: Erin Edwards, Jason Manning, Joe DeFazio, and Matt Brooks

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Chris Willis (00:05):

Welcome to [The Consumer Finance Podcast](#). I'm Chris Willis, the co-leader of Troutman Pepper Locke's Consumer Financial Services Regulatory Practice. And today we're going to be talking about the comeback of foreclosure actions, both residential and commercial, and the implications that has for financial services companies in litigation and otherwise. But before we jump into that topic, let me remind you to visit and subscribe to our blogs, [troutmanfinancialservices.com](#) and [consumerfinancialserviceslawmonitor.com](#). And while you're at it, please check out all of our other great podcasts: the [FCRA Focus](#), [the Crypto Exchange](#), [Payments Pros](#), and [Moving the Metal](#). All of those are available on all popular podcast platforms. And speaking of those platforms, if you like this podcast, let us know. Leave us a review on your platform of choice and let us know how we're doing. Now, as I said, today we're going to be talking about foreclosure, both residential and commercial, how it's made a resurgence and what that means for the industry. And joining me to talk about that are four of my partners, three partners from our Consumer Financial Services group, Erin Edwards, Jason Manning, and Joe DeFazio, and a special guest, Matt Brooks from our Bankruptcy and Restructuring practice group here in Atlanta with me. So welcome to the podcast and thanks for being here.

Erin Edwards (01:16):

Thanks, Chris. Great to be here.

Jason Manning (01:18):

Glad to be back, Chris.

Matt Brooks (01:19):

Thanks, Chris. Good to see you.

Joe DeFazio (01:20):

Thanks, Chris.

Chris Willis (01:21):

Okay, so let's jump right into it. Erin, let me start with you. For those of us who lived through the surge in foreclosures that followed the 2008 recession and were a part of that recession, and then saw us sort of come out of it with very low foreclosure rates

after that, and then probably even lower foreclosure rates because of low loan delinquencies during COVID-19 because of all the government stimulus that was happening, foreclosure kind of seemed like a thing of the past. But the numbers right now are telling a very different story in 2026, in that we've seen these foreclosure rates, both commercial and consumer, start to rise again. And with that rise in rates comes a rise in legal risks for the industry. So, Erin, it seems to me that the Rust Belt and the Mid-Atlantic regions of the country seem to have a higher incidence of this phenomenon than other parts of the country. Why is that?

Erin Edwards (02:16):

That's right, Chris. We're really seeing foreclosure activity concentrating right now in a handful of markets that are clustered in the Rust Belt and the Mid-Atlantic. Dayton, Ohio is sitting about 6% foreclosure rate. Pittsburgh is about 5.3%. Baltimore 5.1%. Philadelphia 4.7%. And of course, those are not just small numbers. They represent a meaningful departure from the national baseline. And it's not just the rates. REO sales, so properties that lenders have taken back and are now selling, those are up roughly 45% year-over-year in Q1 of 2026. Foreclosure listings are approaching 1.3% of national inventory. We're not just talking about a hypothetical turn here, this is showing up in real transaction data. And of course, the question is why these markets? It's really a structural issue. These are regions with older legacy housing stock. The post-pandemic recovery has been slower there than in say the Sun Belt or Mountain West. And you've got population dynamics such as out-migration, softer employment growth that make these communities more vulnerable to the kind of economic stress that leads to a mortgage default. It's not just one thing, but a combination of factors that make these markets structurally less resilient.

Chris Willis (03:34):

Well, Erin, one of the hallmarks of the legislative and regulatory reaction to the surge in foreclosures that started in 2008 was the emergence of a lot of different state laws governing the foreclosure process for residential mortgages. And so all the states in the areas that you talked about have laws like that. So if you're a servicer that's operating in, say, New York, Pennsylvania, Ohio, and Maryland all at the same time, how do you practically manage the four very different sets of procedural requirements for foreclosures in those different states?

Erin Edwards (04:09):

I think the answer is really that it's challenging. It's one of the things that makes servicing in this part of the country just very challenging. And it's honestly one of the biggest compliance traps that we see. You've got four states in close geography that each has their own procedural regime for foreclosure. And they're not just a little different, they're fundamentally different in how they work. New York has a mandatory settlement conference and extended borrower protections that can stretch timelines out. Pennsylvania requires compliance with Act 91 notice requirements before you can even initiate foreclosure. And Ohio has county-level sheriff sale processes and redemption

periods that vary depending where you are in the state. So if you're a servicer with a portfolio that spans all of these states, you really have to understand that you're operating under four distinct compliance frameworks. You can't apply a one-size-fits-all approach. The procedural missteps that get servicers into trouble are often things like missing a notice requirement in one state because you're trying to use the same notice requirements across all states. And that's the kind of thing that can lead to litigation delays, additional costs, and foreclosure dismissal.

Chris Willis (05:19):

So another thing I wanted to ask you about, Erin, is I've heard people talk about an FHA forbearance cliff. What is that, and how big of a phenomenon is it in terms of what's playing out there?

Erin Edwards (05:31):

This is something that I think is really important. It's going to be a defining story for these markets over the next 12 to 18 months. And what we're seeing is that a significant number of FHA borrowers in these regions are now exhausting their loss mitigation options. The forbearance programs and workout tools that were available during and after the pandemic, those have a shelf life. And for many borrowers, that clock is running out now. The practical result is that we're setting them up for a surge in FHA short sales running through 2026 and into 2027. And the markets I mentioned, Dayton, Pittsburgh, Baltimore, Philadelphia, they're going to feel this disproportionately because they already have higher concentrations of FHA-insured loans and borrowers who are more financially vulnerable. So for servicers, the implications are pretty direct. You need to be prepared for increased volume in your loss mitigation and disposition pipelines. And you need to make sure that your compliance with HUD's loss mitigation waterfall is airtight, because as the FHA short sale volumes go up, so does litigation and exposure for servicers who can't demonstrate that they've done a timely compliance review. And this isn't a distant horizon problem, this is a wave that's building now.

Chris Willis (06:43):

That sounds very ominous, Erin. So thanks for telling us about that. So obviously, this situation creates significant legal risks in the residential mortgage market. And Jason, I'd like to turn to you to talk about that. So it seems like anti-dual tracking seems to generate the most private litigation in this area. But what are the most common ways that servicers trip up?

Jason Manning (07:05):

You're exactly right, Chris. It's, I'd say, first and foremost, the anti-dual tracking. I'll also touch briefly on single point of contact and successors in interest, because those are the three, particularly when you see volume increase. Volume equals stress, right? Stress on your process, on your people. And that's where you're going to see gaps arise. And those gaps are what either a state AG or a private plaintiff is looking to exploit. Right? That's what we want to flag, and we want to find it before it becomes an

issue. So dual tracking, very high level, a servicer receives a complete loss mitigation application more than 37 days before a scheduled foreclosure, you must stop. Right? Stop the foreclosure. That completed application trigger is usually what gets litigated. Right? Was it complete? Did you communicate it? And was it acknowledged? That's often the touchpoint for somebody who wants to bring a private cause of action. And the real-world impact, of course, is they want to stop the foreclosure. Right? So they're looking for a way to get an injunction or prevent it from going forward.

And when borrowers start falling behind very quickly, as Erin was talking about, and particularly in those states, the servicing portfolios that were recently onboarded through bulk transfers become especially vulnerable. Right? Because you brought in a whole portfolio and you're just onboarding them. But that could be midstream through a loss mitigation packet. So it's very important to know right away the timing of things and to act accordingly. I mentioned single point of contact, so SPOC, if you will. Similarly, Reg X requires servicers to assign personnel who can access the borrower's full file, explain available loss mit options, and track deadlines. So when call volumes spike, as they do in a foreclosure wave, servicers frequently fall back on call centers or customer support. And that's where things get problematic, let's just say. A practical example is if a borrower calls about a pending loss mitigation application and gets rerouted to different people, they may get conflicting information, they may miss a deadline, or the servicer may miss a deadline.

And so staffing models matter here. And so stress testing your portfolio and your response time is important on the front end before you get to that foreclosure wave, because if you can't do it now, you're not going to keep up when the wave hits. And then third, successor in interest rules. A successor in interest is just typically an heir, a surviving spouse, or a transferee following a divorce. They have to be treated as a borrower once they provide reasonable documentation of their interest. And in foreclosure-heavy markets, a larger share of those distressed properties often involve deceased or incapacitated or successor in interest claims. I've seen a bunch of litigation over this. Our client doesn't realize they're talking to who the new borrower is, right? Because they don't have the documentation. We've got to ask, we've got to find out, and once we receive reasonable documentation, then we got to act on it. All three of these, Chris, rise to the level of potential class action litigation. We're all concerned about litigation and doing compliance the right way, but anytime there's a systemic issue, that's fertile ground for a class action. And it only takes one rep, and then that litigation potentially opens the door to nationwide discovery of your processes and how you treat your borrowers.

Chris Willis (10:49):

Well, Jason, tell me if you agree with this, but I feel like you led off your answer with talking about how a surge in volume will reveal difficulties and problems in a servicing operation, particularly a loss mitigation servicing operation. And to me, that was like the defining story of the 2008 financial crisis and was the source of all the sort of OCC look-

backs and all the stuff that happened back then. And if we're seeing a similar rise, we'd do well to learn that lesson from the past. But the difference is we have all these laws and regulations that were passed in response to what happened in 2008, like the Reg X servicing rules and all the things that you just mentioned, single point of contact, loss mitigation applications, et cetera. So we have the same potential for vulnerability, but with greater legal tools at the hands of borrowers and their lawyers to take action against mortgage servicers. Do you think that's right?

Jason Manning (11:43):

100%, Chris. RESPA is a good example. I mean, it has statutory penalties and it has fee shifting. And those are the two triggers for plaintiffs' attorneys to be very interested because even one individual violation, although it's a \$2,000 statutory penalty potentially, there's fee shifting. Right? So the plaintiffs' attorneys are motivated to dig into this. And usually in a distressed market or a foreclosure-heavy market, the borrower's just going to an attorney with, "Help me." Right? They're not giving specific direction. Savvy plaintiffs' attorneys will look through the entirety of the file and look for that technical deviation in order to use the litigation as leverage to get a better deal than they're otherwise entitled to, because the threat of attorneys' fees is so significant.

Chris Willis (12:32):

That makes sense. Now, Jason, on the regulatory front, I think it's fair to say that the CFPB is significantly less active than it has been in the past, certainly in the past administration. But with that happening, is the regulatory risk just shifting to state attorneys general and private plaintiffs? Because this was an area of significant behavior from both of them during the last surge in foreclosures.

Jason Manning (12:54):

Very much so, Chris. It's interesting because this is one of those places where I'd say the CFPB manual is your friend, because that manual still exists. It still guides the examination process. So if you want to know, "Am I good? Are my procedures good? Is my compliance good?" that's the first place to go to figure out, "Am I at risk for a state AG action, or am I inviting a plaintiff lawsuit?" You just walk through the manual, because that manual is still in place. And even though the enforcement volume has gone down from the CFPB, it really hasn't from the state AGs. In particular, you've got several like California, New York, Illinois, and Massachusetts that are quite active. And the way that they touch these things varies by state. I'll just give you an example. So ECOA, Equal Credit Opportunity Act, may be interpreted federally more narrowly. Different states have different fair lending, fair servicing procedures and requirements. Like the New York AG, it has its own examination and enforcement tools, and private plaintiffs can bring a Fair Housing Act claim with fee shifting. And that's different than under the CFPB framework.

Chris Willis (14:06):

Got it. Well, Jason, thanks for covering those sort of residential foreclosure-related legal

risks with us. Matt, let me turn to you now. It's so great, first of all, to have you on the show, because it gives me yet another opportunity to show off the breadth and comprehensiveness of our financial services practice. You're a member of our bankruptcy and restructuring practice. What are you seeing from the commercial foreclosure standpoint, and how does it differ from what we've just heard from Jason on the residential side?

Matt Brooks (14:32):

All good questions, Chris. The commercial side is a lot different, just because I think the most obvious piece being that you don't have the regulatory overlay. So you're left with, on the borrower side, looking at the loan docs and state law to figure out, "Okay, where's the battlefield going to be if you're going to duke it out with your lender on post-default remedies?" If you're in an Eastern District of New York, for example, where Joe and I often find ourselves, you have potentially a multi-year foreclosure process that you're looking at, compared to a Georgia process where a lot of our commercial bank clients are, where you could do a foreclosure in a tenth of the time. And so you've got a lot of jurisdictions that of course vary greatly, not necessarily with the foreclosure law, but just the timing and whether you're in court or out of court. So that's one key difference. The loan docs themselves is usually where you find battles between borrowers and lenders. And borrowers will look at all different kinds of things, from form loan docs for some commercial banks that were drafted 20 years ago that the provisions aren't clear, all the way to some of our private credit clients that have a little bit more aggressive loan docs that are often more updated, but they have fairly more onerous restrictions on interest reserve replenishments, bad boy guarantee carve-outs, et cetera.

So with all that said, I think the key takeaway from the consumer side versus commercial is the commercial foreclosure workout piece usually varies significantly more depending on the type of the lender. If it's a commercial bank versus a private credit versus a CMBS servicer, all three of those create this environment where they each have different incentives. They have a different management structure, they have different expectations. And that to me is usually the key piece that drives the difference between consumer. And just to throw in some numbers for everybody, just to see what those types of lenders are facing, we're in kind of a new wave of delinquency and special servicer rates. The Wall Street Journal actually just this morning, for something timely, released an article on apartment landlords have 2 trillion in debt that's going to be maturing over the next decade. And of that, I think this year it's almost 300 billion of apartment loans that are going to be maturing. And on the CMBS front, you're looking at the current market has an 8% CMBS delinquency rate. And of that, 10% is now in special servicing. And kind of flipping back to the bankruptcy piece for a second, bankruptcy has been kind of off the news chart lately, but it is up. Commercial filings are up 25% over last year, which was up about 15% over the year before that.

So we're seeing kind of this huge commercial maturity wave coupled with rising bankruptcy filings. And that has created kind of the perfect storm for lenders trying to figure out, "Okay, how am I going to handle a default and a workout? Maybe I don't want the collateral. I don't need another apartment complex. What am I going to do with this loan?" And lenders, again, depending on which type of lender you have, are getting very creative and very active on equity paydowns. We're kind of out of the wave of the extend and pretend. I think lenders are much more attuned and caught on that that's not an effective strategy. So they're really digging in, they're hiring counsel earlier to figure out, "How are we going to solve this problem if there is a solution?" And where I see the litigation now is typically on loans where there aren't any easy answers. And you have borrowers that have really dug in their heels. And that's where we see litigation the most.

Chris Willis (18:34):

Thanks, Matt. And you made reference during your comments to something that sounds very colorful, bad boy guarantees. And I'd like to ask you a follow-up on that. What kinds of borrower conduct are actually triggering springing recourse in this cycle?

Matt Brooks (18:47):

Yeah, bad boy guarantees, you don't really see a lot of those getting triggered. You don't have borrowers that are filing bankruptcy and guarantors that are filing bankruptcy. Where I see it in this market is kind of two different places. One is very technical, where there are carve-outs that aren't necessarily bad, like fraud, misrepresentation, bankruptcy, all the typical carve-outs. There are ratios in the loan for interest reserve replenishments, debt service covenants, and those are triggering these recourse carve-outs, which will honestly surprise a lot of guarantors when they get a demand letter and a lawsuit. We just settled a few weeks ago a couple for clients that was a pretty hard-fought battle just because the guarantors did not think that they had done something wrong. They were cooperative with the foreclosure process. They didn't contest it. But the lenders are, again, they're facing this maturity wall and a lot of delinquencies, and they're looking to recover if they know that the guarantor has some money. The second place that I see these come up is where guarantors just squirrel away money or they don't have anything left, and they will file a bankruptcy to preserve what may be some equity in the property. They're typically not office space or apartments, they're other types of commercial real estate. A lot of them I see in Florida, where you have maintained or elevated property values, like a West Palm, for example. Those borrowers will park a property in bankruptcy and fight with the lender and just say, "Come after me. I don't have anything." And they'll use the bankruptcy as leverage to do a refi or restructure so that if there is equity left in the property, that it's preserved.

Chris Willis (20:36):

Thanks very much, Matt. Joe, let me bring it back to you to bring these two worlds together and talk about how they intersect with one another. So you're seeing both sides of this from your home in New York and elsewhere where you practice. When

residential and commercial foreclosures both pile up in the same market, what actually happens?

Joe DeFazio (20:55):

It really compounds, Chris. So first you get court system strain. Rising filings on both the residential and commercial side clog up the same dockets in judicial foreclosure states, especially the Rust Belt markets Erin was talking about earlier. So what that means is delays, higher carrying costs, and more compliance exposure, particularly the longer a file sits open. You heard Matt allude to before that states here, like New York, where we practice regularly, foreclosures can sit on a docket for quite some time. Then there's this property value feedback loop. So when a residential and commercial foreclosure clusters in the same submarket, typically it depresses values across both asset classes. So that increases loss severity for every lender in that market, not just the ones directly involved in the foreclosure. You will also see a municipal response kick in, particularly with these new vacant property ordinances or zombie properties, foreclosure registration requirements. New York has mediation mandates, the CPLR 3408, and you can get bogged down in those for quite some time with an appointed referee who may or may not release you. And that's really after you're released from there, which you could be in for quite some time, does the case actually really start. And a lot of these apply to both residential and commercial properties. So lenders can get caught off guard if they assume that it's only a residential issue. Often in my commercial cases, some of our clients are surprised to find that some of these residential issues actually also impact them. The last one I would say is reputational risk. So lenders and servicers who can be seen as aggressive foreclosure actors in distressed communities can face some real political and media pressure. And that only intensifies when you're active in both sectors in the market at the same time.

Chris Willis (22:48):

Thanks, Joe. That sounds like a pretty significant problem to have to deal with. What are the practical steps and preparation steps that you think lenders and servicers on both sides, commercial and residential, should take in response to the situation that seems to be bearing down on us right now?

Joe DeFazio (23:03):

So on the commercial side, I would say lenders, especially servicers, should be reviewing their loan documents and guarantee provisions for enforcement readiness. Confirm receivership, UCC foreclosure procedures are current. Coordinate with counsel early on on pre-foreclosure due diligence. You heard Matt allude to that earlier. Some of our clients are actually coming to us much earlier in this process and putting together a strategic playbook because they know the debt is maturing, and they're coming to us earlier to figure out, "Okay, what's the playbook for taking action on this particular loan or this particular property?" And across both sides for residential and foreclosure, I would continue to monitor state and local legislation activity. For us here at Troutman, we do that. We brief our teams and review filings and take note of these statistics so

that our clients are prepared and aware. And we bring a great deal of residential and commercial expertise together on our teams so that our clients are covered on both sides. And for residential servicers, another big one would be audit your loss mitigation workflows, particularly against Regulation X. You heard Jason talk about this before, but you should stress test your single point of contact programs, state-specific procedures. I would run fair servicing analysis. Make sure your vendor management is tightened up. A lot of times I see on the residential side, the vendor will have some issues, and if that's not completely tightened up, that could open the servicer up to liability as well.

Chris Willis (24:37):

Thanks a lot, Joe, and thanks to Erin and Matt and Jason for being on this episode as well. This is a very important warning for our servicer clients to hear, and I really appreciate you all being on the episode today. And of course, thanks to our audience for listening as well. As I said at the top of the show, don't forget to visit and subscribe to our blogs, troutmanfinancialservices.com and consumerfinancialserviceslawmonitor.com. And while you're at it, why not visit us on the web at troutman.com and add yourself to our Consumer Financial Services email list? That way we can send you copies of the alerts and advisories that we release from time to time, as well as invitations to our occasional industry-only webinars. And of course, watch your podcast feed every Thursday afternoon for a great new episode of this show. Thank you all for listening.

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