

Expanding Debt Restructuring Options for Mortgage Lenders in Response to the COVID-19 Outbreak

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Original post [here](#).

With the outbreak of the COVID-19 virus, many countries have instituted some form of right to mortgage forbearance and protection from foreclosure or eviction. Homeowners may request a forbearance of payment for a negotiated or predetermined fixed period. At the end of the forbearance period, lenders work directly with borrowers to recoup the payments missed, by finding alternative payment schedules. Lenders may change the outstanding principal, interest rates, or term of the loan to help the borrower.

Loan Classification

Governments providing forbearance support to borrowers have taken steps to protect lenders who otherwise might experience a dramatic increase in their troubled debt. Typically, such restructuring constitutes a troubled debt restructuring for the lender. When debts are designated as troubled, they are categorized as a loss on balance sheets and a lender must adhere to strict reporting, tracking, and accounting requirements that are administratively costly. Several governments have changed accounting practices so that lenders may avoid classifying restructured mortgages as troubled.

The [United States](#) provides such amnesty for mortgages modified pursuant to the CARES Act. [Peru](#) has pursued a similar strategy, with the Superintendent of Banks notifying financial institutions that any modifications to loan terms due to the COVID-19 pandemic would not change the classification of the loans. [Russia](#) allows banks to restructure loans without impacting their classification, so long as regulatory requirements continue to be satisfied.

Regulatory Requirements

Outside of loan classification, countries have modified regulatory requirements to provide greater flexibility in lending.

[Israel](#) has increased the loan-to-value cap on residence-backed loans from 50% to 70%. Residence borrowers are now eligible for the lowest rate of interest on a home loan at a 30% down payment instead of the original 50% down. Separately, governments are modifying bank capital requirements to improve liquidity conditions; [Russia](#) has specifically reduced risk weighting of mortgages to alleviate the burden of mortgage debt restructuring.

Meanwhile, [Norway](#) has increased the amount of risk banks may take to provide greater flexibility for loan restructuring. Now, 20% of mortgages may deviate from amortization requirements, providing extra room for borrowers to suspend payment or reduce payment. [Sweden](#) has followed a similar strategy, allowing some loans to be exempt from amortization requirements under recognition of income loss for borrowers.

[Freddie Mac](#), a government-sponsored entity (GSE) in the United States, has also provided more flexible options for its lenders, by extending options for restructuring typically only available to lenders during natural disasters.

Unified Loan Restructuring

Rather than provide individualized opportunities for loan restructuring, some governments have elected to provide broad, prescriptive terms for loan restructuring. The US did this in the GFC by encouraging restructure options. This may restructure loans quickly in an environment with less experienced lenders, who have [trouble restructuring loans in a timely manner](#).

In the [Philippines](#), members of the Government Service Insurance System have been extended the ability to settle debts through the government pension fund. Individuals may also consolidate and restructure debts with the organization without penalty. The broad restructuring does not leave space for individual negotiations, with all participants receiving the same reduced interest rate of 7-8 percent from the original 12 percent interest rate.

The Philippines is not the only country setting unified terms of restructured loans at a national level. In the [United Kingdom](#), mortgage forbearance is mandated for three months, already setting one of the terms for lenders for any relief that may be provided. Similarly, [El Salvador](#) has extended a three-month payment exemption for mortgages and other critical services whose repayment would be spread over two years with no risk of default or interest.

Other countries determined payment terms of the mortgage forbearance restructuring. [Palau](#) requires interest-only payments, rather than forbearance outright. [Bolivia](#), similarly, is suspending only principal payments for mortgage forbearance. [New Zealand](#) is suspending principal and interest payments for six months for all individuals affected by the COVID-19 virus.

Aid to Lenders

By providing flexible options for debt restructuring that do not penalize the lender for borrower non-payment, governments may be attempting to mitigate the sharp drop in capital flows that will soon affect lenders due to the many mortgage forbearance and eviction moratoria that have been instituted worldwide.

Extensive but temporary regulatory changes as well as broader guidances in debt restructuring may help banks, but still leave room for difficulty amongst nonbank lenders. As a team of Fed economists wrote in a recent [paper](#), “Nonbank mortgage companies also need to finance the costs associated with servicing defaulted loans for extended periods of time. Obtaining this financing can be difficult in times of strain.”

It remains to be seen how this liquidity stress will be mitigated as forbearance extends into the future. In the US, lenders have asked for the Federal Reserve to institute a [mortgage liquidity facility](#), though nothing has been created yet. The [Federal Housing Finance Agency director has expressed confidence](#) that private banks will continue to extend credit to lenders for the short term.

To read more about residential mortgage forbearance and eviction moratoria, click [here](#).