PUBLICATION

Walking Dead? Beware the Zombie Foreclosure

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The so-called "zombie foreclosure" is a new, big CFPB issue. A zombie foreclosure is a foreclosure that is started, then the borrowers either move out of the property before receiving or just after receiving notice. Subsequently, the servicer halts foreclosure and charges off the loan due to the property value, code violations or one of any number of reasons. When the loan is charged off, the borrower is not informed that the foreclosure has stopped, and the property sits vacant. The servicer, having charged off the loan, takes no further action regarding the property. The borrower, zombie-like, unknowingly continues to accrue tax and code violation liability and technically still owes the money on the note (unless there is a Bankruptcy discharge or lien release). The borrower cannot sell or donate the property even if they are aware that the foreclosure has stopped due to the lien. And there the property sits, while the borrower shuffles aimlessly forward.

So how is the CFPB attempting to cure the zombie virus? The CFPB is using Truth in Lending regulations which require delivery of periodic statements to borrowers as its latest weapon. See, 12 C.F.R. § 1026.41. Here's the catch -- once the loan is charged off, there is likely no further action taken on the account, including sending monthly statements. The CFPB has taken the position that once the foreclosure has stopped, the loan is de-accelerated and thus the borrowers are entitled to statements (and notice) that they are still liable on the loan. No case law has yet developed on this issue, but this TILA provision is a method for the CFPB to justify weighing in on urban blight cases, which could result in exposure to lenders and servicers. The solution? There is none yet and the industry must think creatively before these zombies take more than a bite out of the bottom line.