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Business as Unusual

**With Servicers Stretched to Their Limit,
It's Time to Take a Closer Look at the Fed's Home
Affordable Modification Program—Including the
Snags Hindering Its Success**

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There has been a wave of recent articles and news items dedicated to the Obama administration's Homeowner Affordability and Stability Plan (HASP), and the subset of this program, the Home Affordable Modification Program (HAMP). Most experts agree that loan modifications are not the silver bullet for the state of homeownership or improving the national economy. They are but one tool in the toolbox. There is no question, however, that modifications hold the promise of assisting the largest number of troubled borrowers with the least amount of effort per loan.

Now six months into the program, it appears the administration is not pleased with the progress. This is evidenced by recent comments from Treasury Secretary Timothy F. Geithner and HUD Secretary Shaun Donovan. Both admitted the program is not moving as quickly as the administration would like. They have called upon mortgage servicers to expand staffing and call center capabilities, and to expand the level of trained staff to help borrowers. But are the servicers stretched beyond their abilities?

The answer varies by servicer, though one thing is certain. No servicer can afford to think it is business as usual these days. It is now time to re-think past approaches to the situation and to study the true effort behind HAMP.

Upon examination it appears there are two particular areas that stand out as impediments to putting significant numbers on the board: borrower contact and document processing capabilities.

BORROWER CONTACT

This is most likely the single-most debated topic in loss mitigation today. It boils down to how do we get through to all these troubled borrowers? Various articles on the subject speak to borrower contact rates ranging from 5 percent to 60 percent, depending on whose talking (and whose numbers you trust).

The traditional approach to borrower contact is based on snail-mailed letters and telephone follow-up. It works well for borrowers who are still in their home and are responsible and determined to keep their homes. But this method does not reach all borrowers. The programs should instead be designed to ensure that every responsible borrower desiring to stay in the home is at least given an opportunity to speak with a counselor and be considered for the program. To date, several servicers and vendors offer door knock or in-person counseling services that so far have improved contact rates. But what other options should we consider?

There are several ways to improve contact with those homeowners who can benefit the most:

Improve Awareness >> While our industry media have been full of information about the administration's programs, the majority of delinquent homeowners likely are not plugged into these information sources. A simple discussion with your neighbors or someone outside of the mortgage industry will lend credence to this fact. As such there is still a general lack of awareness by homeowners regarding the available programs. Perhaps it would be useful to employ public service announcements. Television and radio messaging could be targeted to homeowners alerting them to available programs and their benefits. The ads would direct interested homeowners to call external third-party centers, where trained representatives could provide most-needed information.

Though many borrowers today are not aware of the programs available, many simply do not respond to letters and phone calls. Therefore, many servicers are resorting to door knocks to engage the borrower. This approach, while assumed to be more effective than phone calls, is still dependent upon the borrower's willingness to engage.

The range of borrower profiles and emotions is wide. Borrowers can be responsible and eager, or—just as easily—jaded, frustrated, and suspicious. Unfortunately, phone calls and door knocks are only as effective as the willingness of the borrower to cooperate. By increasing borrowers' awareness of the options available to remedy their situation, we can expand their knowledge, boost their response to letters and calls and improve their reception to in-person counseling.

On-Site Outreach Events >> There are many community programs and associations designed to assist borrowers in preventing foreclosure. These programs, national in scope and local in execution, are in many cases partnering with the nation's largest banks to assist borrowers. Outreach events hold the promise of helping hundreds of borrowers in a single afternoon. And they have been the topic of much discussion.

Logistics, however, often hinder the success of these types of events. Determining borrower eligibility is neither quick nor painless. Borrowers must demonstrate and document their income and expense figures, prove occupancy and meet the appropriate NPV and DTI tests. Furthermore, an in-person counseling and evaluation session must be conducted with each borrower at the event. These sessions can last up to 30 minutes per borrower. Any sizable event would require hundreds of counselors, and even then borrowers would be standing in lines for hours. Yet in light of these challenges, outreach events hold the promise of helping a number of borrowers and should be carefully considered as part of a home retention campaign.

Fulfillment Capacities >> As noted earlier, much has been discussed regarding borrower contact. But the HAMP program and other loan modification programs go much further than borrower contact. That's simply the tip of the iceberg. There are significant operational challenges that exist for fulfilling HAMP or any other loan modification program. Quite a number of borrowers have, in fact, made responsible contact with the servicer only to be put into the queue for months. These are not hold queues where borrowers sit on the phone for extended periods of time. No, these borrowers are stuck in the bowels of the paperwork processing queues. They're mired there because performing a successful loan modification takes a significant amount of paperwork and manual processing.

DOCUMENT PROCESSING

Letter Campaigns >> When one thinks of borrower contact, most often a call center scenario comes to mind. But there is a significant amount of paper transfer that goes into this effort. HAMP and other loan modification processes often begin by mailing the borrower solicitation letters asking them to make contact. Following that contact, the borrower is mailed an offer or agreement to sign and return. A copy of the signed agreement and eventually the final modification agreement is then mailed to the borrower.

For each successful modification, the servicer is mailing three to five different packages totaling as much as 30-plus pages of documentation. It is not uncommon for large servicers to mail more than 100,000 packages and to print more than three million pages monthly. In addition to the substantial equipment and facilities infrastructure required to support this function, the servicer, regardless of its size, must have a rock-solid tracking and inventory control system. Considering that each letter represents a troubled borrower, the servicer cannot afford to have even one letter misdirected, jammed in a printer or lost in the mailroom. Successful loan modification inventory control systems are more typical of manufacturing operations than the mortgage industry and include imaging and data capture, in addition to quality control and underwriting.

The following are some of the more significant areas that require strict inventory control:

Imaging and Indexing >> All the paperwork from the borrower must be receipted and tracked to make certain each and every piece of paper from the borrower is received, scanned and indexed to ensure successful tracking.

Data Capture >> Borrowers are required to provide proof of income and occupancy and, in some instances, proof of expenses. This "proof" comes in many inconsistent or non-standardized forms. As such the process of capturing data from these documents is more than simple data entry. In fact, the data entry operator must be familiar with a myriad of documentation to support occupancy, income and financial condition (none of which are standardized in nature) in order to accurately capture the data.

Quality Control Review >> The documentation requirements HAMP places on the borrower are substantial. Borrowers must sign, and in some cases notarize documents. Borrowers must provide copies of pay stubs, tax returns, a 4506T and utility bills or other proof of occupancy. In some cases, they must provide divorce decrees, child support payment documentation, or letters from employers that tips, bonuses, etc. will continue for three years. These documents must all be provided, and a failure to sign, date or deliver all copies of a document will impede the borrower's ability to qualify. Therefore, it is critical for the servicer to review all relevant documents, identify the inevitable errors, and work with the borrower to cure these document deficiencies.

Underwriting >> Ultimately, the work product that results from these efforts should provide the necessary information to underwrite the loan. Here, all the information painstakingly gathered from the steps is evaluated, and ultimately, a decision is made for the borrower.

It is in these documentation processing queues that many borrowers find themselves holding. Servicers are not accustomed to making underwriting decisions, and the fear of making a mistake that might result in a future repurchase has made the process even more intimidating.

Never in the history of the servicing industry has the country seen the scale of fulfillment processes necessary to complete loan modifications that this economy warrants. As such, vendors with experience applying inventory control and manufacturing disciplines have stepped into the mix of companies processing modifications for the lenders.

Many servicers have already re-evaluated their processes and are incorporating new and innovative thinking into their traditional loss mitigation operations. Others have chosen to outsource some or even all of their functions to vendors to assist with volumes and overflow.

Borrower Eligibility >> Borrower eligibility continues to be an issue. Unemployment is a major problem amongst the solicited candidates. They may have taken alternative work, but their ability to demonstrate a consistent and reliable flow of income for three years is not always possible. These borrowers are looking for assistance, but need time to obtain employment that will allow for HAMP eligibility.

LOSS MITIGATION OUTSOURCING

The traditional model of loss mitigation utilizes vendors who have taken responsibility for managing the entire process with the borrower. Vendors are paid based upon their level of success with each loan. This mirrors the traditional servicer approach, but requires additional capacity to handle influx of added volume.

The substantial increase in volume generated by this market requires a change to the traditional approach to outsourcing. A more efficient way to manage in this environment is to evaluate the necessary discrete functions, and to identify outsourcing partners with specific competencies in these areas. Many of these partners are providing assistance to many servicers, and can therefore bring economies of scale to the process, which is especially beneficial to servicers with limited staff not used to seeing defaulted portfolios. Furthermore, specializing has enabled these partners to build efficient processes and specialized technology into their solutions. The critical component to successfully managing this approach, however, is minimizing the impact of handoffs between the various parties. Servicers should take care to ensure the process is divided among various partners utilizing logical breakpoints. Otherwise borrowers could be shuffled between partners, creating further confusion and frustration.

PROGRAM SUCCESS?

It is obviously far too early to truly ascertain the long-term success of this ambitious undertaking. While there does seem to be some immediate concern being voiced about servicers' ability to meet the requirements of the program, it should be noted that little more than six months has passed since this program was initially announced by the Obama administration. Consider that over those six months, investors, GSEs and servicers have had to determine how they were going to meet the administration's requirements; reviewed very specific pooling and securitization requirements to ensure compliance; and determined delegated authority both at the investor and insurer level. They made staffing adjustments or outsourcing arrangements to handle the volumes, stratified and analyzed portfolio segmentations, and determined regulatory and compliance requirements at the local, state and federal levels. Moreover, they understood reporting requirements associated with the program both at the investor and treasury levels, made system upgrades to support NPV and waterfall calculations, and trained staff on the idiosyncrasies of the program.

Without a doubt, this is an undertaking of Herculean proportions. It was undertaken beneath a microscope trained on National Policy with the understanding that failure is not an option. The public's expectation was that servicers were ready to begin doing modifications the same day as the program's announcement.

At this stage, most servicers have made significant progress in executing their initial stages of the offering. Additionally, many of the questions that were raised in the program's first 60 days have now been answered, giving comfort and direction to servicers regarding the implementation of their processes and procedures. Since the average timeline for borrower response and execution runs between 30 and 45 days, and most servicers began their initial solicitation campaigns between 60 and 90 days following the initial announcement, results are just now starting to be realized. Logically, the results reported throughout the third and fourth quarter will undoubtedly show much more success than what has been reported to date.

Whether or not the upcoming quarter's statistics will ultimately meet the goals of the administration remains to be seen. In the meantime, however, if even a few of the key operational components are addressed, it can improve the servicer's immediate performance.

As those results are realized and reported, additional solutions will inevitably be developed to continue chipping away at the problem in hope that ultimately we will begin to see the economic improvement the program was designed to spark.