20th Anniversary

SERVICING MANAGEMENT®

THE MAGAZINE FOR LOAN SERVICING PROFESSIONALS ◈ VOL. 21, NO. 10 AS FEATURED MAY 2010

Reversing Directions: Servicers Drive Short Sales Forward

From rearranging departments to implementing pre-approved pricing strategies, servicers are searching for new ways to streamline the many moving parts involved in short sales.

By John Clapp

How do you transform complex and historically accidental transactions into tightly controlled, premeditated actions? That's the question facing many servicers today as they look to improve their short-sale processes in advance of what are expected to be record-high volumes.

Though home retention remains the order of the day, it is well understood that servicers' ability to transition delinquent borrowers into reperforming status is limited. Bloated real estate owned (REO) inventories and their associated costs, however, make the traditional response to defaulted loans – foreclosure – less appealing for servicers than ever before. Add in the ever-present political pressure on servicers to avoid foreclosure, and the newfound popularity of short sales seems only natural.

REO management has always been an expensive function of servicing, but today's lengthened holding times, combined with municipalities' sharpened focus on limiting blight, are prompting servicers to consider every alternative to foreclosure – particularly short sales, which provide borrowers the added benefit of a dignified exit from the property. The difficulties impeding such transactions, though, are numerous. Short sales are unwieldy, involving multiple stakeholders (buyers, sellers, brokers and potentially mortgage insurers, if not several lienholders). The presence of so many different parties has resulted in drawn-out time frames and high percentages of lost sales.

Moreover, the transactions have been largely consumer-driven to date, requiring servicers – who have rarely had to take the lead – to develop new execution strategies. But given the favorable economics of a short sale as compared to a foreclosure, servicers appear willing to shift gears.

"Realistically, the number of short sales, if servicers put effort behind managing them, should eclipse the number of REO transactions," says Chad Neel, president and chief operating officer of LPS' Asset Management and Field Services divisions. "The reason they don't is because there are so many impediments to getting them done, and the deals are not driven."

To counter this trend, shops have taken a variety of approaches, from reallocating staff and rearranging departments to implementing price-approval strategies that begin with the servicer. The overriding goal of these operational changes is to improve efficiencies and, in turn, truncate the average time it takes to complete a short sale. Current time frames vary throughout the industry, but a process as long as 180 days is not uncommon.

"Generally, when you move faster in a liquidation event, you mitigate more loss, and short-sale transactions will allow us to do that in almost all cases," says Matt Vernon, head of Bank of America's REO and short-sales unit. "Obviously, we're going to look at each transaction and measure that financial view of that specific case, but ultimately, a rule of thumb is, speed is your friend when you're looking to mitigate a loss on behalf of the investor, as long as the offer is one of fair market value."

Bank of America's REO and short-sales unit doubled its negotiator population last year and expects to do the same this year, with the new additions being front-loaded into the first half of the year. The servicing giant's first-quarter short-sale volumes were more than twice its fourth-quarter 2009 volumes, Vernon says.

Vernon

The company's strategy of grouping together its REO and short-sale departments is gaining traction in today's market. As short sales grow from one-off transactions to bulk scale, servicers are increasingly leveraging the expertise of their REO personnel, who are already familiar with the broker management, offer negotiation and collateral valuation pieces that are characteristic of short sales. Traditionally, short-sale negotiators have been housed in servicers' loss mitigation departments.

Rather than combining REO and short-sale operations, some servicers are opting to set up stand-alone short-sale units within their loss mit departments so as to alleviate capacity concerns. Fifth Third Bank has segregated its short-sale staff, because the transactions – being so high-touch – necessitate more legwork and greater coordination than most tasks, says Jon Meade, vice president of loss mitigation. The company has also placed dedicated short-sale staff in Florida, one of its biggest markets for portfolio loans.

"I find it's much easier to control quality when [the staff] is focused on one workout type," Meade comments, adding that short-sale clients, if viewing a transaction as too slow-moving, are quick to escalate their complaints. "You can't carry the same caseload on a short-sale portfolio as you do on a loan mod portfolio."

A federal affair

The federal government's involvement in servicing is certainly not limited to loan modifications. Starting last month, all servicers participating in the Home Affordable Modification Program (HAMP) were required to solicit for short sales all borrowers who are ineligible to receive HAMP modifications. This component of HAMP, known as Home Affordable Foreclosure Alternatives (HAFA), provides incentives to borrowers, servicers and investors to complete short sales, and is expected to impact, perhaps indirectly, broader short-sale activity in the market.

"Overall, I think the program will help ease the logjam of deals outstanding by hopefully streamlining the process, while giving borrowers and Realtors comfort that the servicer is motivated to get a deal done," says Stephen Weiss, vice president of business development for Foreclosure Response Team.

The exact level of sales to be performed under HAFA is uncertain, as concerns remain that subordinate-lien holders – historically the biggest obstacles in transactions – will balk at the federal incentives, which have already been upwardly revised once. But what HAFA is expected to accomplish is a general reshaping of industry views toward short sales. The program requires servicers to approve or deny short sales, based upon pre-approved listing prices, within a rigid 10-day period. It also sets a baseline understanding of how far subordinate-lien holders and private mortgage insurance (MI) companies should go in terms of accepting payoffs, at least from the government's perspective.

Completed Foreclosures and Other Home-Forefeiture Actions

	12/31/08	3/31/09	6/30/09	9/30/09	12/31/09	1Q% Change	1Y% Change
New Short Sales	16,809	18,619	25,128	30,766	37,584	22.2%	123.6%
New Deed-in-lieu-of-Foreclosure Actions	1,186	1,298	1,120	1,233	1,054	14.5%	-11.1%
Completed Foreclosures	94,942	90,686	105,995	118,606	128,895	8.6%	35.7%
Total	112,937	110,603	132,243	150,281	163,224	8.6%	44.5%

Source: OCC/OTS Mortgage Metrics Report. Q4 2009

"HAFA itself probably won't increase short sales, but the standardization of the derivative factors – having something to point at and make people talk about – should absolutely increase the number of short sales," says Jim Satterwhite, executive vice president of National Quick Sale's parent company, Infusion Technologies, and a member of HOPE NOW's Making Home Affordable Short Sale committee.

HAFA requires servicers not only to proactively reach out to borrowers to begin the short-sale discussion – guidelines mandate that borrowers be contacted about HAFA options within 30 days of falling out of HAMP – but also to determine an acceptable listing price ahead of time.

In other words, the government program forces servicers, for at least parts of their portfolios, to build process around an otherwise unrefined transaction. And unlike HAMP, the HAFA concept was announced almost a full year before its effective date. Specific program guidance was rolled out about five months in advance of mandatory compliance, and the reporting requirements and time-frame expectations have been well established.

"Time was our friend here, versus [with] HAMP," says Vernon. "It's been an incredibly complex process, and it's been dependent upon HAMP in many respects, so it still has a degree of complexity that's embedded within. But we've learned from HAMP."

One large question about HAFA is still looming. The program is not yet required by the government-sponsored enterprises (GSEs), but some believe it is only a matter of time until Fannie and Freddie roll out their versions. And when they do, virtually every servicer will be affected.

"A lot of servicers I'm speaking to still have blinders on, saying 'I'm not affected because I'm not a HAMP servicer,'" says Scott Gillen, senior vice president at Stewart Lender Services (SLS). "But a lot of that is the fact that the GSEs have not come out with their announcement yet … We've all seen them ramping up and getting ready for it."

Bank of America is working with the GSEs and other investors for comparable programs that give servicers and borrowers the same benefits that HAFA does, Vernon says. Fifth Third's Meade says he wants clarity on the GSE issue.

Because HAMP is such a report-heavy initiative, many shops – including Fifth Third's – have segmented HAMP loss mitigation from their core loss mit activity. Lacking a clear handoff point in HAFA leaves open the possibility for unnecessary back-and-forths between HAFA and non-HAFA negotiators – a predicament that would surely frustrate all parties to the transaction.

"The right way to manage it is to draw a line in the sand – it's HAFA or it's not – and if it's HAFA, here are the data requirements for Treasury that are due on the fourth business day of the month," says Meade. "That's what I'm hoping I'll see from Fannie and Freddie … so my segregated team knows when it's theirs and when it's not."

Beyond HAFA

Just as the push for loan modifications in recent years has resulted in a multitude of end-to-end loss mit service offerings, HAFA has triggered an increased vendor presence in short sales. The services and products are wide-ranging. Several tech providers are offering transaction-management software. Some short-sale companies have formed partnerships with auction companies and open-house specialists intended to maximize the exposure of listings. Bundled-service providers have rolled out both HAFA-specific programs, as well as proactive, non-HAFA programs that begin with a borrower solicitation.

"That's going to be very important when subordinate-liens or MI companies, for whatever reason, don't agree to HAFA guidelines and you've got the backup plan to support the short-sale transaction, which is basically more flexible with subordinates and MIs," says Travis Olen Hamel, chief operating officer of Loan Resolution Corp.

Satterwhite

Lender-directed short sales can serve not only as a HAFA backup, but also as the primary liquidation option for servicers not currently engaged in HAFA. By most estimates, servicers began implementing such proactive strategies the middle of last year, shortly after the initial HAFA announcement. The objective of these efforts is to accelerate credit loss. Whereas in the past, short sales were largely an expense play that enabled servicers to save on foreclosure costs, property maintenance and cost of service, proactive short sales allow servicers to cut loss severities in a housing market where many property values are still deteriorating. It all goes back to an age-old default servicing mantra: Your first loss is the smallest loss. But to drive transactions to fruition (and gain efficiencies), servicers must be able to identify and solicit short-sale candidates, as well as be willing to perform certain due diligence earlier in the process.

Before last year, "Almost every program we saw was a reactive program," says SLS' Gillen. He describes that as a tenuous process at best, given one side of a proposed transaction involves an eager buyer, and the other side is a borrower who's speeding toward foreclosure.

"That process has been in place for as long as I can remember," he says.

Proactively identifying which borrowers are likely to want short sales involves attuning call-center operations to key words and phrases. "Realtors," "underwater" and "listings" provide insightful clues on borrower mentality and whether a decision has already been made that the home is unaffordable, Gillen explains.

Through portfolio analysis, servicers can identify which properties are listed and for how long. When coupled further with an understanding of those borrowers' recent credit-score activity, portfolio scrubbing can filter the candidate pool, Satterwhite adds. Advanced title curative provides an early snapshot of encumbrances other than the first mortgage. The benefit to servicers is that they can focus their energies on transactions that stand a realistic chance of closing. SM