LOSS MITIGATION
» IT’S TIME TO GET DOWN TO BUSINESS

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A WORD WITH
STEVE STAID AT LITTON LOAN SERVICING
RESPA & REO
We’ll go ahead and say it now: Loss mitigation is THE buzz word of the year. We’re only halfway through 2006, but there isn’t a single topic looming larger on the minds of both servicers and the secondary markets as the mortgage banking industry begins its headlong charge into the third and fourth quarters. The reason why this is the case isn’t too hard for anyone keeping up with popular press to fathom. An astronomical rise in exotic mortgage originations, vastly expanded access to subprime credit, increasing mortgage rates and slowing property appreciation has every mortgage servicing professional—to say nothing of the general consumer—wondering if the time has finally come to pay the piper.

THE COMPLEXITY OF A SIMPLE IDEA

At its most basic level, the loss mitigation function isn’t really rocket science. It deals with one very simple idea: help keep the losses that are invariably associated with default to a minimum and help get a delinquent loan performing again if at all possible.

But this simple idea has become more complex than ever in today’s securitized world, where servicers will often find themselves trying to serve many different masters: insurers, bond guarantors, trustees, investors and whoever is sitting on the powder-keg called first loss position (i.e., the residual bond tranche that represents the proverbial front end for any loss impact).

“There is a definite difference between the conforming side of the business and the non-conforming side,” says Todd Sibley, CEO of Salt Lake City-based Titanium Solutions, whose company provides face-to-face loss mitigation services to servicing operations nationwide. “Then you have go one step further: In the non-conforming side, does the servicer or its affiliates own any piece of the mortgage risk? That will determine how much they can do at any given point in time.”

It’s a complex balancing act, and one that requires an understanding of what key factors impact bond performance. “There are two things you have to pay attention to in order to get optimal performance results for a bond: default frequency and loss severity,” says Steve Staid, executive vice president at Houston-based Litton Loan Servicing. “Loss severity, by and large, is something that is beyond direct influence—you cannot go faster than the process of law allows, you can’t sprinkle magic dust on your REOs and liquidate them faster than everyone else can and your cost of funds is set at the coupon rate you have to pass through to the investor.”

That often leaves default frequency as the sole factor that a servicer can influence to ensure that a mortgage-backed security performs as is or better than expected—and that’s squarely where the
loss mitigation function comes in. “Our job is to make sure that no loans default at the end of the day,” Staid says.

Loss mitigators have admittedly had it easy for the past few years. After all, interest rates were at historic lows and many properties were literally skyrocketing in value, creating the most favorable operating conditions the mortgage banking industry had ever seen—refinancing activity, anyone?—but evidence is now mounting that the party is coming to its inevitable (and hopefully quiet) end. Moody’s Economy.com, a research firm in West Chester, Pa., estimates that more than $2 trillion of U.S. mortgage debt, or about a quarter of all mortgage loans outstanding, comes up for interest-rate resets in 2006 and 2007.

With loss mitigation looking more and more like the proverbial dam that will be asked to hold back a potential flood of default activity, now is the time for servicers to get more creative than ever. But how?

OFFER NEW OPTIONS TO TROUBLED BORROWERS

Innovation is nothing new to most industries, but in loss mitigation, the options available to troubled borrowers today don’t differ much from what the troubled borrower was offered in the mid-1990s. Dean Williams, CEO of Tulsa, Okla.-based Williams & Williams, hopes to change that. His firm is actively working to introduce the real estate auction paradigm into the rubric of loss mitigation.

The program, called ASAP (Assisted Sales Auction Program), is a pre-foreclosure sale program that offers an interesting alternative to the traditional short sales approach taken in loss mitigation. Borrowers choosing to enter ASAP are given a cash “equity” advance from Williams & Williams toward relocation. Within 45 days of the borrower’s enrollment, a lender receives the highest possible cash-as-is offer for the property from third-party buyers. The lender may choose to accept the offer for payoff or settlement, accept a deed-in-lieu or proceed with foreclosure at no additional risk or expense.

Williams says the program got its start from private borrowers calling in and asking for sales assistance. “On a daily basis,” he says, “we get calls from borrowers who say, ‘I just saw your company come to our neighborhood and successfully sell a home in what looked like 30 days. I’m being foreclosed on, trying to sell my home, and I’ve been unsuccessful.’”

The program has certainly yielded interesting results since its recent inception. “We’ve found surprising things,” says Williams, “like prices above appraisal or BPO values, or a sales price that yields equity at sale.”

Perhaps most interesting, however, is the success the program has seen. “While this is a new program, we’ve done a couple hundred of these to date,” Williams says. “We’ve had 100 percent success—not 99 percent but 100 percent. As you can imagine, it didn’t take me long to get on the bandwagon on what this program could mean.”

Not that Williams expects his company’s ASAP efforts to be a panacea for the industry—far from it. After all, not every borrower will elect to enter the program and sell his or her home. “I’ve argued that servicers should begin conversations that get beyond what the borrower isn’t doing and recognize that we’ve chosen to create a lot of innovative financing and extend more people access to mortgage credit. So what’s wrong with choosing to increase their options in workout?”

INCREASE THE REACH OF LOSS MITIGATION EFFORTS

Expanding available options is certainly a good start—but only if troubled borrowers know what options are available to them to begin with. A recent joint study by Freddie Mac and Roper Public Affairs and Media found that more than six in 10 late-paying borrowers were unaware of a variety of workout options that could help them overcome short-term financial difficulties. At the same time, 92 percent of these borrowers said they would have talked to their servicers had they known these options were available to them.

Extending the reach of loss mitigation all the way to the borrower’s front doorstep and, hopefully, to his or her kitchen table, is what drove the inception of Salt Lake City-based loss mitigation specialist Titanium Solutions. A unique operation, the company trains and certifies its own national network of LMCs (loss mitigation consultants) who work directly with borrowers who are often missed by traditional phone and letter-mailing campaigns to help them understand the full range of options available that can help avoid a foreclosure.
“Our LMCs are there to help, to provide information and to document the borrower's circumstances,” Sibley says. “The most effective time to bring us in is after 60 days, but other servicers will use us at other points in time. We have one client that uses us after each first-payment default, because they can’t sell the loan if the borrower misses that first payment. Others may use us as the last stop before going to foreclosure.”

The key challenge in establishing meaningful face-to-face contact with troubled borrowers, says Sibley, comes down to timing. “If we come in after the notice of default is filed,” Sibley says, “then every bottom-feeding investor, every bankruptcy attorney and every real estate agent looking for a listing has already hit them up. At that point, it becomes considerably more difficult to convince the borrower that we’re really there to help.”

**CHANGE THE RULES OF THE GAME**

Beyond offering new loss mitigation options and increasing the reach of mitigation efforts, many servicers are gearing up for a fight of a different kind: this time, against the enemy within. “We’re about to get an entirely new cause of default,” says Litton’s Staid, “and it is the mortgage instrument itself.”

Staid points out that traditional causes of default are often due to changes in a borrower’s condition—death, divorce, job loss and the like. But what if the borrower’s condition doesn’t change? What if the mortgage note, and not the borrower, is the cause of default? “The conversations with borrowers that we as servicers better be prepared to have isn’t about the same sort of default situations we’ve always had;” he says. “Nothing will have changed in [the borrower’s] household, yet they will default nonetheless.”

Litton is a unique servicing operation in that the company, through its affiliation with C-BASS (Credit-Based Asset and Securitization LLC), owns a first-loss position in roughly 90 percent of the assets it services, either through origination and securitization or through third-party purchases. This obviously creates a strong impetus for the company to do all it can to prevent a foreclosure—and the loss associated with it—from having to take place. But it also means that the company must negotiate across hundreds of pooling and servicing documents that essentially set the rules of the game in loss mitigation.

It’s this complexity that has led the operation to discover new opportunities. According to Staid, Litton invests significant resources in reviewing each and every pooling and servicing agreement it operates under and will seek to change the rules of the game whenever and wherever it feels is necessary. “If we don’t like the language of the pooling and servicing agreement,” he says, “because we think it’s limiting to our customers and to the investors—if it puts everyone at increased risk of loss—we will usually try to get the agreement amended.”

According to Staid, the ability to redefine the playing field will become mission critical in instances where defaults are being driven from within. “Maybe [the housing bubble burst] doesn’t happen,” Staid says. “But if it does, there is no amount of collecting you can do to solve for the problems associated with the underlying note.”

“Those pooling and servicing agreements you’re beholden to? You’d better check them all to make sure that you have the right to restructure a borrower’s loan to solve for this problem. Because if not—if you can’t do it—there is no amount of loss mitigation work out there that will help. You may as well change the term to something else, like loss assurance.”