There's Got to Be A Better Way

IN marketing circles there is a concept known as "brand exhaust." It's the idea that every business or industry, for all its good intentions, has residual and sometimes undesired output. Think of the film "Super Size Me" and how it relates to the negative results of eating fast food. For mortgage lending, the undesirable exhaust is clearly foreclosures. * Since 1995, loan innovation as well as production simply exploded. From online application technology to historically low interest rates, no-down-payment programs to interest-only financing, the mortgage banking industry decreased the time and cost to finance property while simultaneously expanding the loan options available to practically every consumer. * Few can argue with the benefits achieved by the industry's pursuit of its core mission—to provide a more liquid and transparent finance system to serve the interests of mortgage investors and borrowers. This increase in liquidity has furthered the dream of homeownership for millions of families by making loans

Offering seriously delinquent borrowers a way to avoid foreclosure is the way of the future. Early results show that voluntary pre-foreclosure property auctions are netting solid values for distressed homeowners. They can also save lenders from steep foreclosure-related losses.
more affordable. The progress that’s being made underlies an even larger vision for an “ownership society.”

One thing that hasn’t changed is the time and cost involved in selling a home. While today anyone can sell stocks, autos or practically any other tangible property easily, directly, quickly and for less than ever before, real estate sales remain illiquid and costly.

As anyone who has bought or sold more than a few properties can attest, home sales are anything but time-definite, cost-efficient or transparent. Asking prices for most real estate are still set, and then the seller hopes for the “right” buyer. There is little open or competitive bidding, and actual current market values are often anyone’s guess. The cost of this overall illiquidity becomes most painfully obvious when a homeowner can no longer afford to make his or her mortgage payments and faces default and possible foreclosure.

Based on the Mortgage Bankers Association’s (MBA’s) National Delinquency Survey for third-quarter 2005, released in December 2005, foreclosures have risen to more than 500,000 annually. While defaults as a percentage of all outstanding loans remain historically low, the tremendous growth in the number of mortgages has resulted in large numbers of foreclosed properties. To many, this is a shocking number of families who lose their homes each year, especially in light of the unprecedented appreciation in property values over the last decade.

No one wins in foreclosure. That is why today’s lenders are adamant about trying to keep every borrower in his or her home if at all possible. They are keenly aware of the massive toll on human dignity and the financial loss that occurs. Cities, communities and even other property owners all suffer from the subsequent costs, depreciation and blight caused by vacant properties sitting for sale. This brand exhaust from mortgage lending is coming under increasing scrutiny from government and consumer advocates as servicers continue to go through the lengthy process of foreclosure and traditional real estate–owned (REO) sales.

While some of this might be unavoidable, in my view there is significant opportunity here for the lending industry to further lead in preserving property values, lowering costs and serving customers.

Why do foreclosures happen in the first place? As the chief executive officer of a top-10 lender recently noted, foreclosures happen “when someone is either unwilling or unable to pay.” Those unwilling to pay are typically involved in some degree of fraud, whether for profit or property. Those unable to pay most often are those who have experienced a significant life event such as divorce, job loss or a health emergency.

As most of us can appreciate, people in these circumstances have a hard time seeing any hopeful options that might be out there. Even though many lenders offer options such as loan modifications, homeowners in severe financial distress still perceive correctly or otherwise that they simply cannot no longer afford the payments related to owning their property. The options to them seem to boil down to either trying to sell their home and move on, or forfeiting their fate to bankruptcy, eviction and/or foreclosure.

Faced with this reality, few argue with the advantages that accrue if a pre-foreclosure workout or “short sale” could be accomplished. These transactions involve the lender accepting less proceeds than due.

Many responsible borrowers in such situations do in fact try to sell their property on their own or through a local agent. But during this loss mitigation period there are some daunting questions needing answers, and fast. For instance: Is the home worth more or less than owed? How do you openly and quickly attract buyers, especially if market value is less than the mortgage? How will the borrower and lender know that any offer received represents market value and their best (lowest) loss? How long will it take to get the best offer, and will it close before the scheduled foreclosure? How will the borrower afford to relocate?

Not being able to get timely answers to these questions is what dooms the homeowner as well as the lender to endure further anguish, costs and ultimately foreclosure.

Others are starting to take notice of this situation. The Fannie Mae Foundation funded the National Vacant Properties Campaign (NVPC) to study the problem of real estate sitting unused, vacant and either for sale or abandoned. The NVPC found that “For those living among them, vacant properties are nothing short of a curse. Neighbors are forced to tolerate eyesores that attract crime, arson, vermin and dumping. Derelict buildings present safety and fire hazards, reduce property values and degrade environmental health and quality of life.” The NVPC also found that the costs of this illiquidity and waste go beyond the communities affected, causing substantial harm to real estate values.

In a 2001 study prepared for Research for Democracy, a joint project of Temple University Center for Public Policy and Eastern Pennsylvania Organizing Project, Philadelphia, entitled
Blight Free Philadelphia: A Public-Private Strategy to Create and Enhance Neighborhood Value, the NVPC noted that "Houses within 150 feet of a neglected vacant property experienced a net loss of value of $7,267. Those within 150 to 300 feet experienced a loss in value of $6,819 and those within 300 to 450 feet of such a property depreciated by $5,542." A 1995 study noted by the NVPC entitled The Costs of Sprawl and Urban Decay in Rhode Island, prepared for Providence, Rhode Island-based public interest group Grow Smart Rhode Island by J.C. Planning Consultants Inc., Orange, Connecticut, and Planimetrics LLP, Avon, Connecticut, reports: "There were nearly 11,000 vacant and abandoned properties in Central Falls, Newport, Pawtucket, Providence and Woonsocket, Rhode Island. Experts estimate that this represents a $1.3 billion loss in property value for these five cities."

Last September, The Columbus Dispatch published a four-piece series entitled "Brokered Dreams," chronicling Ohio's national lead in foreclosures. Headlines included "Residents from All Walks of Life Lose Their Jobs at Sheriff's Sale" and "Suburban Blight." The front-page stories offered excruciating detail about the inability of Ohio homeowners to sell their no-longer-affordable properties pre-foreclosure, thereby triggering tremendous loss for all concerned.

In an article in the first installment of the series, co-author Geoff Dutton wrote, "Foreclosures are fueled by aggressive mortgage brokers, appraisers and others who profit regardless of whether the loans ultimately succeed or fail."

A study by William C. Apgar and Mark Duda, Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom, published in May 2005 by Harvard University's Joint Center for Housing Studies, Cambridge, Massachusetts, and funded by the Homeownership Preservation Foundation, Minneapolis, found that "the foreclosure of a single-family home, especially one that leaves the home vacant and unsecured, may, in some cases, generate direct municipal costs on cash-strapped public agencies in excess of $30,000 per property. Typical costs include loss of tax revenue, increased policing, increased fire department activity (due to arson and/or vandalism), demolition costs, building inspections, legal expenses, costs associated with managing the foreclosure process, and increased demand for social services programs."

Many avowed industry critics point to the lending industry as the primary source of the problem of vacant properties sitting for sale. This attitude evidences a lack of understanding of how the mortgage industry functions. These groups fail to grasp that mortgage servicers suffer financial loss whenever foreclosures happen.

Nevertheless, this type of anti-industry sentiment appears to be growing. In a report last June entitled Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure 'Rescue' Scams, the Boston-based National Consumer Law Center (NCLC) stated, "A very considerable role in this distress is also played by the nation's lenders, with their increasingly reckless extension of credit plus their striking array of grossly unfair and extremely high-priced credit products, collectively known as 'predatory lending.'"

While targeting the foreclosure rescue scams created by get-rich real estate investors (and advertised via the "We Buy Houses!" billboards and signs seemingly posted on every street corner in the United States), the NCLC concludes that the lending industry must be at fault for not offering a better solution. Privacy issues aside, the NCLC makes the case that if lenders want to make the loan in the first place, they should at least help a homeowner no longer able to afford those payments retrieve any possible equity and dignity pre-foreclosure, with some modicum of effectiveness. It probably would come as a surprise to NCLC that those very steps are being taken with growing success by lenders every day.

Even so, seeing a neighbor first lose a job, then be unable to sell his or her home, then be foreclosed and evicted or forced to file bankruptcy—resulting in a vacant and deteriorating structure standing "for sale"—can be quite an eye-opener for even the most staunch industry advocate.

For many others with little understanding of the industry, it can be seen as unfair, a costly waste and something that someone should do something about. While these sentiments may not be new, they are increasingly being raised as public-policy concerns. The timing of this discussion, interestingly enough, comes at a time when real estate owners overall have experienced the largest and longest run up in property values in years. In today's society, the obvious question is: Who will be blamed if things don't stay so rosy?

Beyond talk of slowing appreciation, indications of rising interest rates or even the presumed return of traditional market cycles, the most threatening possibility, in my view, is that lenders will be increasingly viewed as directly responsible for any significant or further rise in foreclosures. Instead of heralding the ownership society, politicians and consumer activists could easily start lamenting the creation of a debtor society. This is not a public-relations battle the lending industry wants to engage in.
Early intervention

Meanwhile, troubled borrowers aren’t returning phone calls. Servicers know that maintaining contact with customers in default is critical to achieving a pre-foreclosure workout. And investors even offer the servicers incentives for each pre-foreclosure short sale approved. But as an August 2005 Freddie Mac/Roper Public Affairs and Media survey entitled Foreclosure Avoidance Study showed, borrowers continue to risk losing their homes rather than discussing options with their servicer.

While 75 percent of the delinquent homeowners recalled being contacted, 92 percent did not discuss their situation or follow up with the servicer because they simply did not see how the lender could help. As Ingrid Beckles, Freddie Mac’s vice president of default asset management, recently stated, “This survey is telling us that we’re trying, but our efforts are not connecting with people that need the help.”

David Dill, president of Fort Worth, Texas-based Saxon Mortgage Services Inc., noted in an article entitled “Default Management,” appearing in the February 2005 issue of Servicing Management, “If subprime borrowers get past two payments in arrears, you’re taking their whole month’s income to try to get them current—which is virtually impossible. It is absolutely essential to conduct early mitigation efforts in your front-end collections group to keep these customers from getting that far behind.”

Dallas-based Homecomings Financial, a GMAC-RFC company and major servicer of nonprime mortgages, has reported success recently in getting borrowers to stay in contact by unifying its default communications under one brand, “realChoices, Open Doors”—both internally and externally in all print and electronic messages. The idea is to inform borrowers about the workout solutions available while providing a consistent reminder of the lender’s desire to help. At the 90-day delinquency point, for example, the company changed its messaging to de-emphasize the need for payment and instead tout the workout options available.

Recent pilot programs by Fannie Mae and Freddie Mac have experimented with having foreclosure firms inspect properties to see if they’re abandoned and dropping off a loss-mitigation packet for the defaulted borrower. Reports on the progress of the pilot programs indicated that 60 percent of these borrowers called the law firm rather than the servicer, and of those, 40 percent took the time to fill out Fannie Mae’s loss-mitigation worksheet. The calls are spurred by the law firm’s default notices, which are also complemented by a letter suggesting that there are possible workout solutions. Once contact is established, a handoff to the servicer ensues for crafting a workout.

The bottom line seems to be that borrowers facing foreclosure, who lack means to make anywhere near the payments required to bring the loan current, need real solutions beyond offers to modify the loan. They need direct assistance in pre-foreclosure marketing and sale of their property, and most likely, cash for relocation assistance. Servicers would tend to benefit more financially by following this path, as it lessens the typical losses that accrue on an average REO sale. If these options were communicated from the outset, the servicer’s phone might start ringing.

New approaches

Leaders within the lending community should prepare to confront the real issues from the customer’s perspective, and develop new and effective alternatives to foreclosure. There are opportunities available now to meet these challenges head-on and forestall burdensome regulation, negative publicity and class-action lawsuits.

Many borrowers in default and facing foreclosure benefit from counseling, and need relocation assistance or “cash for keys” to vacate the property. On this front several national credit-counseling and housing-assistance agencies, including my company, have spearheaded a campaign to work with lenders in providing direct assistance to borrowers to help them get a new start in avoidance of bankruptcy and/or foreclosure.

The Minneapolis-based Credit Counseling Resource Center (CCRC), launched in 2002, is comprised of three nonprofit counseling agencies—Auriton Solutions, Roseville, Minnesota; Novadebt, Freehold, New Jersey; and Springboard, Riverside, California. Together with participating mortgage servicers and the alliance of credit counselors, the CCRC has counseled more than 40,000 homeowners in its three years of operation, according to the CCRC. These nonprofit agencies and lender/vendor offers of direct assistance afford borrowers an additional contact and resource beyond traditional loss mitigation, as well as more face-to-face consultation when needed.

A positive alternative

Two years ago, our company started offering servicers and investors direct-to-market REO disposition via open-pricing auction methods to improve their net return on asset sales. Hundreds of these property sales now occur nationwide every month. Dozens of individual
borrowers, already in foreclosure, have since reached out on their own to contact the company after seeing one of these auctions in their neighborhood. As the sales are time-definite (only 35 days on market), these homeowners were asking if there was a way to sell their property to try to quickly settle their unpaid debt with their lender.

During a pilot conducted in fourth-quarter 2005, 10 of these individual borrowers—all currently already in foreclosure and/or bankruptcy—were allowed to enroll their properties, and each respective lender was advised of the upcoming sale. All 10 auctions resulted in borrower- and lender-approved sales that closed prior to foreclosure.

Even more encouraging, two of the properties that the borrowers had tried but failed to sell on their own via traditional methods sold for more than their last asking price. And net proceeds for three of the properties exceeded full payoff. In other words, the current market value on one-third of these properties in default was actually much higher than had been estimated. Substantial borrower equity would have been lost, or further lender losses incurred, had foreclosure still occurred, resulting in REO.

A typical case in point was a homeowner in Pipe Creek, Texas, who, after losing her job and quickly entering loan forbearance, had tried unsuccessfully to sell her home for more than a year. She eventually reduced the asking price to $275,000 with lender approval, while the unpaid debt ballooned to $285,000. In this pre-foreclosure auction program, the property sold for $295,000 in 35 days and closed well before the scheduled foreclosure.

It is worth noting the added opportunity afforded servicers today to educate borrowers of these new or other workout efforts created by the passing of the new bankruptcy law. The law requires borrowers to present a certificate from a nonprofit credit-counseling agency before filing a chapter 13 or chapter 7 bankruptcy. If a borrower has not received credit counseling, a bankruptcy attorney cannot accept his or her money or file bankruptcy. Once the borrower has located an approved credit-counseling agency, the borrower must wait 180 days before filing, and during this period receive the certificate stating he or she received a briefing on credit-counseling options and assistance in conducting a budget analysis.

Combining the benefits of time-definite auction sales that encourage open, competitive bidding and thus transparency as to value, with the consultation and financial assistance offered via credit-counseling, gives mortgage investors and servicers a chance to assist borrowers otherwise facing extreme distress and loss. It also gives the industry an opportunity to reassert its mission and true intent—to support affordable property ownership.

In a climate where every week lenders face more laws labeling a growing list of practices as “predatory,” it seems especially important for the industry to become proactive in offering customers who are in distress a meaningful chance for a new beginning.

The “elephant in the room,” as any REO disposition manager can attest, is that knowing what a particular property is truly worth remains one of life’s great unanswered questions. You can price a property for supposed full value only to see it snapped up within the first days or hours on the market by an investor who then flips it for substantial gain; or alternatively price a property below value only to see it languish unsold until, after repeated price reductions, it is finally sold for only a fraction of the original estimated value. As an Aug. 25, 2005 Wall Street Journal editorial, “The Realtor Racket,” noted, “The process by which most homes in the U.S. are still priced and marketed comes with less-than-stellar transparency, competitive bidding or cost savings. It is not a system that works well when time, money and openness matter most.”

A multibillion-dollar industry is vested in supporting the legal, property preservation, outsourcing, REO management, preferred local agents and their investor clients—all veterans of “the way things have always been done.”

Yet from NASDAQ to Amazon and eBay, opening markets to auction-marketing technologies has lowered costs, increased buyer/seller confidence and created more reliable, time-definite results that have tremendously benefited consumers. Is it possible that this could happen for real estate as well? Alternatively, can mortgage lenders afford to endure continued real estate illiquidity and resulting foreclosures?

While the mortgage industry may be facing some significant near-term challenges, all businessespeople know that most problems also represent opportunities. This may be an opportune time to design and implement solutions that create more liquidity in real estate, or at minimum, offer a viable means to privately settle defaults via voluntary pre-foreclosure sales that minimize losses for all concerned.

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