What is happening in default servicing?
Stories are piling up that depict an almost nightmare scenario of investor loss, borrower despair, and entire communities staring down blight caused by thousands upon thousands of empty homes standing for sale. Though the madness must stop, it seems all hands on deck are tied, tired, or simply thrown up in the air with a rhythmic chant of “what can we do?” How about sell the property, allow and assist the desperate borrower to relocate to more affordable housing, and save the entire country, mortgage investors included, from the increasingly insane loss severity of foreclosure and traditional though numbingly static and staid “asking price” sales of REOs.

Innovation in Origination
Underlying all the talk about keeping people in homes (or is that debtor’s prison?) is a fundamental and unavoidable fact: When a personal crisis hits, there are other values to steward beyond any particular home or mortgage payment, like employment, health, family, or—dare we say—life itself. The sticks, bricks, and land are, contrary to all the hype of the housing industry, replaceable—at least in terms of affordability and suitability. In these instances, choosing to legally sue one’s former though now distressed customer, the borrower, for simply the right to liquidate the property and mortgage claim seems, in 2007, out of sync with industry innovation on the origination end of the mortgage spectrum.

The Fed Speaks Up
According to the Federal Reserve’s report “The Rise in U.S. Household Indebtedness,” this kind of innovation on the origination side led to exactly what we now hear so much talk about: putting and keeping people in homes. As the report states, “The U.S. subprime mortgage market emerged more than two decades ago and then began to expand in earnest in the mid-1990s; it was spurred in large part by innovations that reduced the costs for lenders of assessing and pricing risks. This expansion made homeownership possible for households that in the past might not have qualified for a mortgage and has thereby contributed to the significant rise in the U.S. homeownership rate—from 65 percent in 1995 to 69 percent in 2006.” As “subprime” is in the process of being shortened to a four-letter word, this is an important statistic to remember.

Yet all did not go well, as we now know. The Fed states further in the same report that “to put these developments in a macroeconomic context, the loosening of credit standards along with unrealistic expectations...
With Beleaguered Borrowers Roaring and a Market Coming Off the Tracks, Conductors Will Need Some New Tactics to Avoid Catastrophe.
for house prices probably boosted housing demand in 2003 and 2006, and the subsequent correction is contributing to the extent and persistence of the softness in the housing market.” This analysis by the Fed yields several important points. First, when innovation reduces the cost of assessing and pricing risk, homeownership rates increase. Second, realistic and accurate price discovery is of critical importance for the stability of the housing market. Third, the softness of the housing market persists.

Read any consumer blog or advocacy group’s statements and you'll find building vitriol toward the entire mortgage and housing industry. Not even Congress will be able to craft true solace in their endless but misguided attempts at regulated misfires. But the bare facts remain that housing prices and affordability are becoming increasingly exposed as an almost Ponzi-like scheme to take all the payments anyone could afford and use them to support the housing industry’s Mecca based upon a so-called “American Dream.” This may have profited many agents, loan officers, and mortgage investors, but now the gig is up.

**On the Down-low**

Real estate journalists far and wide predict an extended housing downturn. In October, James Hagerty wrote in *The Wall Street Journal* that some analysts are predicting that most U.S. home prices most likely won’t begin to rise until 2009 or 2010. And Stephen Bedikian explored the problem in *Inman Real Estate News* saying that, despite the fact that some market watchers believe the market will improve within the next year, history says that’s just not so. He pointed out that real estate markets are often referred to as “sticky downwards,” where properties are taken off the market for a while when home sellers don’t immediately get the price they want. And while that might mitigate the price downturn in the short term, he says it tends to lengthen the duration of a market correction. Faced with a market that continues to decline and with a real estate industrial complex that insists on the utilization of speculative selling methods even for non-speculators (for more on this topic, see the November article “The Speculator Next Door”), those in financial straits are turning to bankruptcy, the worst lose-lose of them all. Consumer bankruptcy filings increased 12 percent during the first three quarters of 2007, mostly coming from a 5 percent increase in conforming prime bankruptcies, versus a 32 percent hike in subprime, Alt-A, and jumbo filings, according to First American LoanPerformance.

**Bankruptcy: A Disastrous Decision**

Is bankruptcy the best option borrowers perceive? Upon losing their job or health, or the life of a loved one who provided for them, borrowers wind up facing the loss of their home. The same people who seemed so friendly and cooperative when times were good are now viewed as a menacing threat when times are bad. As if one of the aforementioned personal tragedies were not enough, the borrower must clear their head to face the entity that appears to want to take away still more. Not presented with a range of options like they were at the time of mortgage origination, the borrower feels trapped in a corner and takes the only way out that they know: The disastrous financial choice of bankruptcy.

In the depths of this unfolding crisis, default servicers sit with an exploding set of concurrent responsibilities, rules, ratings, and finger pointing. It’s enough to blind a Dalí Lama, much less an overworked, underpaid loss mitigation and/or asset manager. Sending in listing agents with speculative “asking prices” as their tools is not unlike sending in the clowns—it offers only smiling faces and colorful presentations. This tactic gives up on the most basic, if not also obvious, remedy of selling the home with a measure of transparency and time definiteness so that foreclosure and REO is completely avoided.

Continuing to do things “the way we’ve always done it” looks increasingly unappealing. According to the National Association of Realtors, total existing home sales, which include single-family, townhomes, condominiums and co-ops, fell 8 percent to a seasonally adjusted annual rate of 5.04 million units in September from a downwardly revised pace of 5.48 million in August, and are 19.1 percent below the 6.23 million-unit level in September 2006. The nation’s housing inventory saw a slight increase of 0.4 percent at the end of September with 4.40 million existing homes on the market, which represents a 10.5-month supply at the current sales pace, up from a downwardly revised 9.6-month supply in August. More people need to sell their homes, yet fewer homes are selling through the market value within a time-definite 30 days would seem a good place to start. Bundled together with stipulated terms of property preservation and care, each successful effort could also include a relocation assistance stipend for the borrower in distress toward a new beginning in more affordable housing.

Of course, the common complaint about borrowers when it comes to this type of service is “We can’t usually find them, and when we do find them we have a hard time keeping them engaged.” This is a classic chicken-or-the-egg conundrum. Which will come first—responsible borrowers or borrowers with options? As foreclosure rates continue to rise, the risk associated with business as usual travels with them. Blaming consumers will not fix the problem. The need for a more proactive approach grows more evident every day. And as word spreads that consumers have options—that they could even make money from the transaction—their cooperation will undoubtedly improve.

Current public messaging like that being conducted by NeighborWorks is an important first step to getting them on the line, but once we get them there, we need to have win-win options available for them. One-hundred-year-old foreclosure practices and asset disposition strategies will not meet the cries for change that are seeping out of America’s Dreams.