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Required Content for Real Estate Finance Professionals

Liquidation Nation: New Options For Reducing Inventories

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REQUIRED READING: **Try as it might, the Home Affordable Modification Program (HAMP) cannot resolve the shadow inventory alone**. With only a fraction of the borrowers receiving the attention they need, it's only a matter of time until additional projects become a major focus in the fight to stem foreclosure. Home Affordable Foreclosure Alternatives (HAFA) is a step in the right direction; some of the main elements of HAFA are monetary incentives to borrowers and servicers, as well as standardized approval guidelines for borrowers who do not qualify for HAMP loan modifications.

But there are additional and lesser-known alternatives for mortgage investors, such as bulk whole-loan and real estate owned (REO) sales, and specialized servicing. New technology and specialized talent are key to resolving the swelling number of distressed loans. Advanced REO and short-sale management companies are bidding for more government-sponsored enterprise (GSE) and Federal Housing Administration (FHA) servicing rights to provide proactive solutions.

Servicers with the most sophisticated and proactive approaches to resolving liquidations are seeing opportunity in the marketplace where traditional collection and foreclosure methodologies are failing to produce results. Specialty servicers that can demonstrate advanced technology, deep call-center support and access to field-agent networks for door-knocking campaigns are being awarded new pools of loans, as investors and the GSEs manage their portfolios like generals overseeing a battlefield, sending out triage or reinforcement units to areas of the country that have seen the highest economic casualties.

Public scrutiny and political pressure also affect the GSEs' approach to liquidating properties, prompting a conservative tack. There is a risk that liquidating too many properties will flood the market with inventory and cause further depreciation in some already hard-hit markets. The public relations nightmare of such an event would only further deepen the PR hits that the mortgage giants are taking. It is a tough situation for the GSEs: Many of their latest initiatives to stem foreclosures are unable to overcome the public's negative perception that has grown during the housing market crash.

The Costco approach

The combined REO inventories of Freddie Mac, Fannie Mae and the FHA climbed 22% in the first quarter from the fourth quarter of 2009. This number will continue growing as the year goes on, until major initiatives get under way to reverse it. The good news is that the GSEs have initiatives in the pipeline that are catching on. Fannie Mae sold 260 REO properties in January to 10 investors; Freddie Mac sold 207 properties in April to first-time home buyers in the Las Vegas area (Southern California properties were featured, as well). A recurring theme is beginning to appear in the actions of the largest mortgage holders - one of focus and execution.

The GSEs see the value of bulk sales and mass auctions to reduce their overhead of REO inventories and are moving more homes in that direction. Reversals of long-standing policies that prohibit the use of auctions are beginning to occur. The only limiting factor in this area is the amount of pressure the GSEs might feel from public and political sectors. Prior to the beginning of the year, the GSEs generally had not used giant REO auction companies to dispose of assets, because they were wary of the potential political fallout that could occur over liquidating properties at discounts of 20% to 50%.

One disposition method that solves a major issue regarding affordable housing is to offer - at a substantial discount - bulk properties to Community Redevelopment and Housing Authorities. These agencies' model is to renovate and provide at a very reduced price homes to lower-income professionals, including teachers, firefighters, police and other essentially skilled citizens that are not paid a wage sufficient enough to afford to live near their places of employment in metropolitan areas.

Servicers should not see major impact to their business processes when it comes to REO auctions, as most major servicers have been overseeing large auction sales for the past several years. For investors, bulk sales might even be less demanding from a resource point of view.

Whole-loan portfolio sales

Major forces are at work behind the scenes of the largest financial institutions' trading desks. Several mortgage investment firms are researching the feasibility of wide-scale, whole-loan transaction initiatives. There are rumors and whispers throughout the industry about loan pools being prepared to solicit quiet bids without much media attention. The price gap between sellers and buyers still remains large, and only time will tell if will change due to market conditions. If the gap narrows, whole-loan sales could provide a valuable alternative to foreclosure.

One method might be to discount the pool to a value that allows new buyer to modify the loans into affordable payments while also reducing principal to reduce the borrower's negative-equity anxiety. The workload a servicer could expect in this situation is nothing more than a normal board/de-board process.

Technological micromanagement

The development of timeline managers and vendor management integration are critical to increasing liquidations for the GSEs and the FHA. Technology solutions that address this area are highly desired in the industry, with a premium being placed on a system's ability to track critical events in the timeline of the pre-foreclosure, post-sale and property-listing life cycle, including evictions and closings.

Comprehensive solutions that offer analyst-level event management, automated reminders, workflow and business rules can greatly reduce the risk of missing responses to offers, listing adjustments and other time-sensitive events. Controlling and monitoring communication among borrowers, field asset agents and the investor is one critical area that is often overlooked. A communication breakdown anywhere among the Realtor, servicer and investor (in cases where the servicer does not have full delegated authority) can cause the most damage to the investor's bottom line.

Requests for proposals (RFPs) in this area are hot right now, with system replatforming initiatives an ongoing process at many of the largest financial institutions. This area sees a lot of attention in board rooms because of the impact to the bottom line. Major consulting firms and software providers have moved to address this opportunity and are bidding for work.

Workflow systems aplenty

One major trend in the industry has been the introduction of a number of software solutions that address the one of HAMP's tallest hurdles - attempting to consume a massive amount of paperwork needed to verify income and hardship information. These solutions usually include a workflow and business rules engine to route requests to the right people within departments and provide some process management for the operations department.

A formidable custom solution would include off-the-shelf integration with the nation's largest servicers, Fannie, Freddie and the FHA. The real benefit of these systems is their ability to streamline business processes and communication while providing a micromanagement level of detail to supervisors. This capability is often overlooked, even though it is critically important. Missing something as simple as an inaccurate broker price opinion (BPO) value can cost an investor hundreds of thousands of dollars per loan, or a potential REO or short-sale buyer who decides to walk because a better deal is available elsewhere in the neighborhood.

Servicers have focused much of their attention to workflow solutions for managing their internal processes, but only a few systems incorporate the investor (which is vital in cases where the servicer does not have full delegated authority). In many instances, investors are building their own hybrid management and oversight functions related to servicing. If more servicers offered portals to their systems that provide investor communications for listing feedback and offer approval, the effect on the liquidation process could be major. Short sales could finally be viewed as real options for buyers, rather than time-consuming and frustrating exercises.

Managing counterparties

Putting useful data and collateral documents from Realtors, loss mitigation workout specialists and REO field asset managers to use is another critical component in asset liquidation. The process itself - tracking the various counterparties, their reporting data and collateral documentation, while aggregating it in a manner that provides the quickest method of access by the correct operational staff - can prove immensely challenging. Three areas of data are necessities: collateral valuations (e.g., automated valuation models, BPOs, appraisals), status reporting data, purchase offer documentation. For REOs, it is useful to capture and provide in an online repository the listing details and offer documents.

For short sales, having scanned hardship information, credit reports and bank statements available to the servicer representative at the time a decision is required can expedite the process. Online access where the counterparties can submit and monitor the life cycle of their respective roles in the liquidation process is also critical.

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