# Future of Mortgage Servicing: Findings from Mortgage Servicing Collaborative

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2019 HFA Institute,
January 17th, 2019
Washington D.C.

# The Mortgage Servicing Collaborative (MSC)

- The Urban Institute is a nonprofit research organization founded by President Lyndon Johnson in 1968 to develop evidence-based solutions to pressing social and economic issues
- The Mortgage Servicing Collaborative is an Urban Institute research initiative that started in 2017. Its purpose is to study pressing issues within mortgage servicing and generate support for reforms
- Collaborative members are diverse stakeholders including lenders, servicers, subservicers, consumer advocates, academics, policymakers, and trade associations
- MSC Website: https://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-servicing-collaborative

# What we Heard on Shared Research Priorities

- Conducted a survey of MSC members at the very beginning to identify major pain points:
    - Challenges servicing FHA loans
    - Government Loan Modifications
    - Cost to service nonperforming loans
    - Misalignment of servicing standards
    - Access to credit
    - Servicing compensation
    - Role of Technology

# Collaborative Research Published So far

The collaborative has published three comprehensive policy research reports:

- Government Loan Modifications: What Happens When Interest Rates Rise?
  - Most government loan modification programs aren't designed to provide meaningful payment relief during rising rate environments

- Reforming the FHA's Foreclosure and Conveyance Processes
  - Addressing pain points in FHA's foreclosure timelines, penalties and property conveyance process

- The Case for Uniform Mortgage Servicing Data Standards
  - Explains how adoption of servicing data standards can be a win-win for consumers and servicers

# Government Loan Modifications: What happens as interest rates rise?

# The Problem with Government Loan Modifications

- Loan modifications rely on three primary levers
  - Interest rate reset to market rate
  - Term extension
    - The term is extended to spread out payments
  - Principal deferral (partial claim)
    - A portion of principal is forborne until home is sold/loan payoff
    - The remaining balance is used to calculate the new monthly payment

- Rate reduction is the most economical, but doesn't work when rates rise. Why?
  - Securitization rules require the rate to be reset to the prevailing market rate, which can be higher or lower than the original rate
  - If market rates are higher, payment relief becomes difficult to achieve
  - Increases dependence on partial claims (more costly for taxpayers) or term extension (more expensive for borrower)

# Long-term mortgage rates


Source: Freddie Mac Primary Mortgage Market Survey, 30 year FRM

# Example: Modifying a 3.5% mortgage at a 5% rate

| | Original loan (at default) | FHA mod. (partial claim) | GSE Flex Mod (100% MTMLTV) |
|---|---|---|---|
| **UPB at default** | $148,000 | N/A | N/A |
| **Capitalized UPB** | N/A | $152,243 | $152,243 |
| **Partial claim or MRA** | N/A | $44,400 | $7,888 |
| **Interest-bearing UPB** | N/A | $107,843 | $144,355 |
| **Interest rate** | 3.5% | 5.0% | 3.5% |
| **Remaining term (months)** | 330 | 360 | 480 |
| **P&I** | $699 | $579 | $559 |
| **Taxes and insurance** | $250 | $250 | $250 |
| **Monthly MIP** | $167 | $167 | $0 |
| **Monthly payment** | $1,116 | $996 | $809 |
| **Delinquent payments** | 4 | 4 | 4 |
| **Monthly payment reduction** | N/A | -10.8% | -14.7% |

- Most government loan mods result in a higher rate post reset, adding to the monthly payment
- To achieve payment reduction, FHA has to offer more partial claim assistance, which is both expensive and capped at 30 percent
- Even though FHA spent more money on the modification, the payment reduction is less

# How can we avoid rate increases for modification?

- Background:
  - FHA, VA and USDA loans are securitized into Ginnie Mae MBS and sold to private investors
  - Under Ginnie Mae guidelines, servicer must buy out delinquent loans from the MBS, cure the default, and re-securitize the loan and sell to investors
  - The new security has to be sold at the market rate otherwise no investor will buy it

- The solution: Allow loan modification without re-securitization
  - Delinquent loan is not purchased from security; retains old rate
  - Modified through partial claim/term extension
  - Reduced loan balance is re-amortized at the original note rate
  - Marginally higher cost is borne by MBS investors

# Payment Relief Under MSC's Proposed Solutions

| | Original loan (at default) | FHA partial claim with recast |
|---|---|---|
| UPB at default | $148,000 | N/A |
| Capitalized UPB | | $152,243 |
| PC/MRA or forbearance | N/A | $44,400 |
| Interest-bearing UPB | | $107,843 |
| Interest rate | 3.5% | 3.5% |
| Term | 330 | 330 |
| P&I | $699 | $509 |
| Taxes and insurance | $250 | $250 |
| Monthly MIP | $167 | $167 |
| PITI | $1,116 | $926 |
| Delinquent payments | N/A | 4 |
| Monthly payment reduction | N/A | -17.0% |

- Allowing the borrower to retain original rate results in bigger payment reduction; reduces the amount of partial claim, saves taxpayer dollars
- Flexibility to combine with term extension, partial claim or temporary MIP reduction

# Reforming FHA's Foreclosure and Conveyance Processes

# FHA Foreclosure Process

- The FHA Foreclosure Process Is Complex and Costly
  - Intermediate timelines for first legal, reasonable diligence, and conveyance as opposed to a single unified timeline
  - Cannot make up lost time
  - Penalties for missing intermediate timelines even if foreclosure is completed on time
  - Penalties are not proportionate to the harm caused

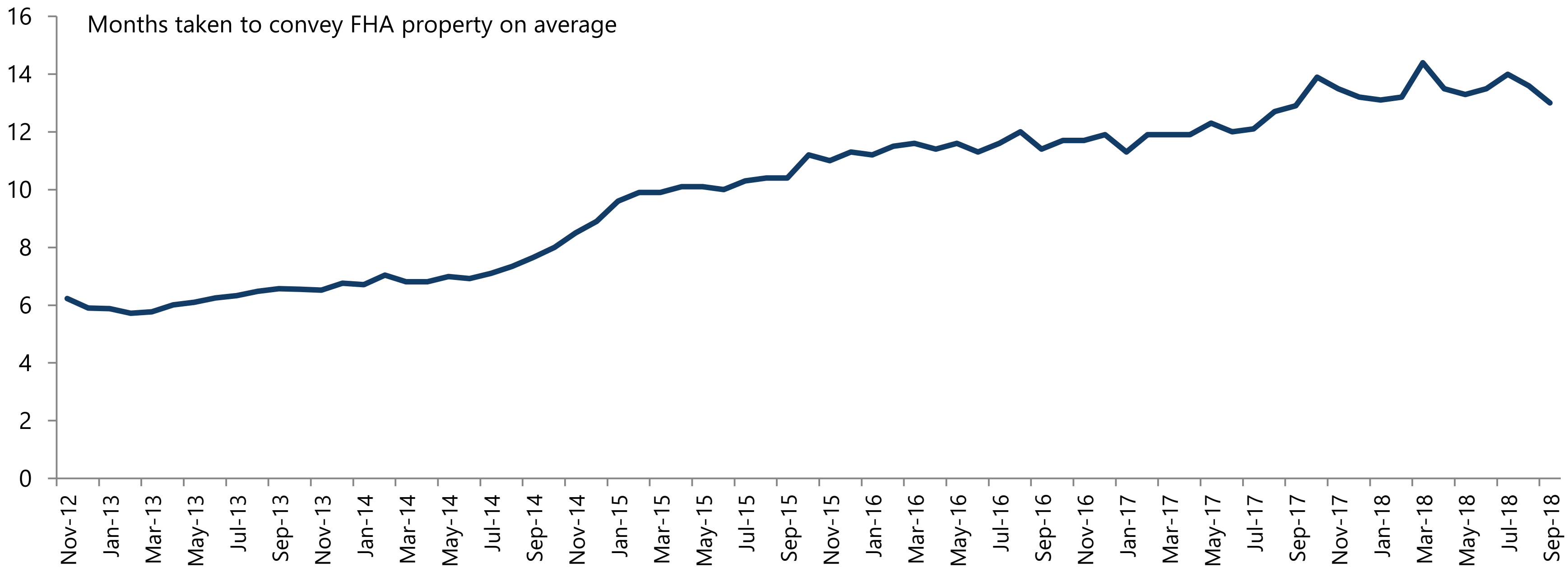
**Financial Implications of Missing First Legal Action and Reasonable Diligence Dates among 2015 and 2016 FHA Claims**

| | Share of claims with interest curtailment | Average interest curtailment on claims | Average days from last paid installment to foreclosure | Average days of interest curtailment accumulated | Share of foreclosure days for which interest curtailment accrued |
|---|---|---|---|---|---|
| Missing the first legal action date | 29% | $5,360 | 692 | 559 | 81% |
| Missing the reasonable diligence date | 14% | $4,619 | 692 | 302 | 44% |

Source: Data from servicer members of the Mortgage Servicing Collaborative.

# FHA Conveyance Process

- Unlike GSEs and VA, FHA does not have direct conveyance, i.e. it doesn't take possession at auction
- Servicers have 30 days to convey, during which they must repair the property within FHA allowances. When estimates exceed allowances, obtain FHA approval then repair the property to "conveyable condition"
- Iterative and time consuming process that requires coordination between FHA staff, property inspectors, servicers, and repair crews




Source: FHA Single-Family Loan Performance Trends Report

# Key Findings and Recommendations

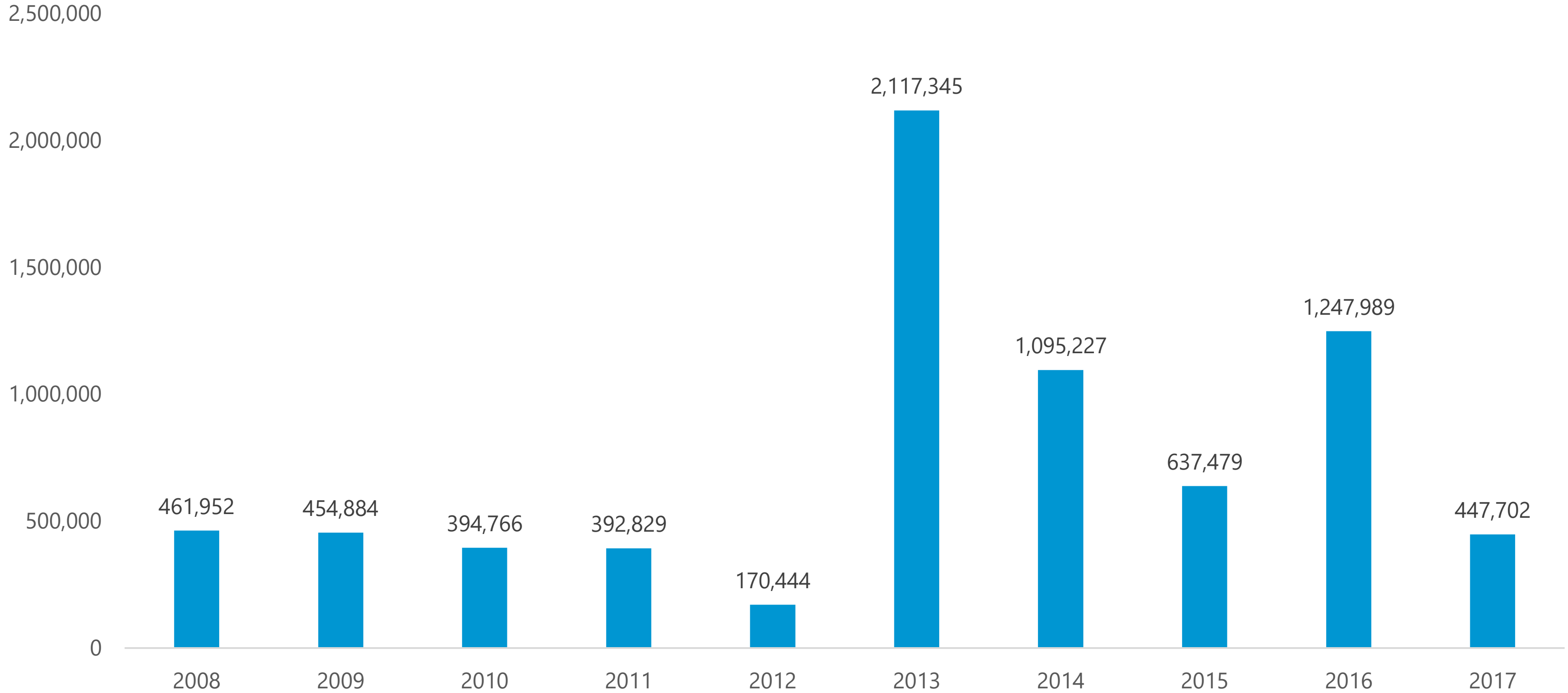
- It takes an average of three years from the default to conveyance
- Slow resolution of distressed assets results in properties remaining vacant for longer and adversely impacting nearby home
- Higher loss severities for FHA and large property maintenance, repair costs and penalties for servicers.
- According to MSC servicers, on average it costs three times more to service an FHA non-performing loan than a GSE NPL

- Recommendations:
  - Move to a unified foreclosure timeline from default to conveyance
  - Align penalties with actual delays
  - Change property conveyance model: Adopt direct conveyance or expand conveyance alternatives

# The Case for Uniform Mortgage Servicing Data Standards

# The need for servicing data standards

Number of GSE Loans Servicing Transferred, by Year of Transfer

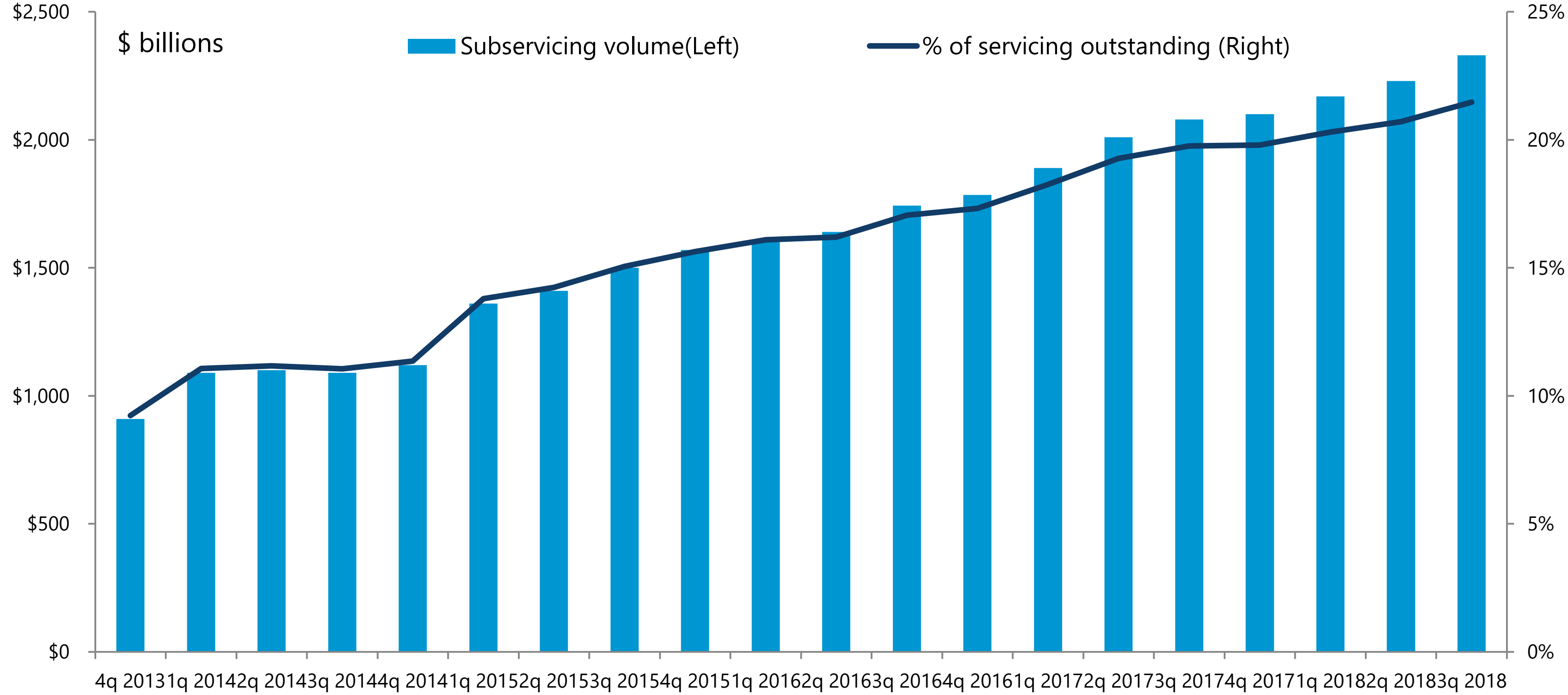



Source: GSE loan-level credit data.

- Servicing transfer was not just a crisis era mechanism for offloading delinquent loans to specialty servicers. It has become a permanent fixture of the mortgage market
- Frequent servicing transfers require frequent data transfers; greater risk of data errors

# The need for servicing data standards

Single-Family Subservicing UBP: Volume and Share




Source: Inside Mortgage Finance.

- The subservicing market is larger than ever and growing – Over $2.3 trillion in UPB was subserviced as of 3Q 2018, 22% of total outstanding
- Significant volumes of data are exchanged when a subservicing arrangement is put in place

# The need for servicing data standards

- Lack of data standards over the years has led firms to build custom data models that suit their own business needs:
- The way data are defined and used varies across stakeholders, making it very difficult for systems to talk
- Data needs to be mapped and processed to ensure compatibility. Time consuming, costly and error prone
- Potential for borrower harm – inconsistent data can result in denial or delay in receiving modifications, erroneous foreclosures, or poor customer service

# The need for servicing data standards

- Per J.D. Power 2018 Primary Mortgage Servicer Satisfaction Study:
  - Smartphone usage: only 20 percent of servicing customers reported using mobile technology, vs. 39 percent for credit card users and 55 percent for retail banking customers
  - Use of mobile technology by servicing customers *declined* from 22 percent in 2016 to 20 percent in 2018

- In a 2018 FHFA survey of servicers, 60% said data accuracy and completeness were biggest challenges during transfers; just as many highlighted high variance in data as a problem

# Benefits of data standardization

- Standardization would drastically improve data quality industry wide
    - Fewer errors during transfers and subservicing would significantly cut the risk of borrower harm
    - Largely obviate the need to perform data mapping, reduce costs for servicers

- More efficient regulatory reporting
    - Reg requirements have expanded drastically post-crisis: more data points need to be reported, to multiple regulators, each of which have their set of requirements. In response, servicers have doubled or tripled their operations staff, increasing costs.
    - A common language between regulators and industry would reduce the need to customize reports, improve data accuracy, and reduce costs

# Benefits of data standardization

- Longer term, data standards can pave the way for greater innovation
- A standard data model can serve as the baseline around which tech innovators and entrepreneurs can build highly scalable applications
- Lots of innovation on the front-end, very little in servicing
  - Origination data standards have paved the way for advancements, such as automated verification of borrower income and assets, development of more sophisticated AUS, and home valuation models
  - Origination R&W relief was made possible by better-quality data GSEs collect under uniform loan delivery standards
  - Data standards on the front-end have allowed GSEs to process origination data electronically, helping improve speed and accuracy
- Stakeholders should begin the work of implementing uniform servicing data standards; broad MSC agreement that servicing transfer is a good place to start as it can reduce both, costs for servicers and the potential for borrower harm

# Now is the time

- More than 10 years after the worst financial crisis in a generation, the mortgage industry is once again stable and strong
- Strong macro environment – Low unemployment, rising wages, and very low delinquencies
- The consensus view is that a recession will come in the next 1 to 2 years, defaults and foreclosures will rise, more borrowers will require loan modification, and more servicing will be transferred
- Strengthening the servicing market in good times like today can help us respond quickly and effectively to the next downturn

# Stay Informed on Urban's Housing Work

## ✓ Recent Urban Institute Housing Finance Research

- Mortgage Servicing Collaborative - http://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-servicing-collaborative
- 2019 FHA Trends to watch – https://www.urban.org/urban-wire/four-trends-watch-federal-housing-administration-2019
- Upcoming leadership change at FHFA – https://www.urban.org/urban-wire/what-expect-calabrias-leadership-federal-housing-finance-agency
- 2019 Housing finance issues to watch – https://www.urban.org/urban-wire/housing-finance-issues-watch-2019
- Self employed borrowers - https://www.urban.org/research/publication/continued-impact-housing-crisis-self-employed-households

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