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Understanding the Creditor's Perspective on Home-Mortgage Modifications

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While previous articles in this series have focused on the debtor's perspective on mortgage modifications, this article will focus on the creditor's viewpoint. By understanding the creditor's point of view, we can demystify the process and gain critical insight into the challenges servicers face and what debtors can do to help address those issues.

> When a residential property is heading towards or in default, mortgage modifications are often the best solution for all stakeholders.

Take foreclosure as an example. It is devastating for the homeowner. And it is concurrently expensive and difficult for the creditor.

First, creditors stand to lose significant amounts of money when homeowners default on their loans. According to a special report by the Joint Economic Committee in 2008, lenders may lose up to $50,000 for each home foreclosure.[1] These costs have steadily increased in recent years and are only going up with today's high inflation rate.[2]

Second, creditors are not property managers. They are ill-equipped to manage and maintain properties during and post-foreclosure. Monitoring and maintaining properties is time-consuming and costly, and involves the risk of something going wrong which may require additional creditor investment.

Third, even if a debtor has equity in the property, any equity remaining after the foreclosure will be paid to the debtor. Contrary to common perception, a foreclosure rarely results in windfall gains for the creditor. A debtor, with positive equity, can always avoid the foreclosure by selling the property, paying off the mortgage and retaining the equity. This decision is entirely in the debtor's control.

If foreclosures are expensive, time-consuming, and rarely profitable for a creditor, why does it seem that default alternatives, like mortgage modifications, are so difficult to complete to keep the property out of foreclosure?

The likely answer is complexity. Creditors, like debtors, face many challenges and struggle through the mortgage-modification process as well. Federal, state, and local regulations as well as investor rules and guidelines pose complex (and sometimes conflicting) requirements. Document requirements are rarely straightforward and vary from household to household. Applications and supporting documents are frequently submitted to the servicer from different sources, at different times and are often piecemeal. Finding quality employees, especially in the current labor environment, is also difficult. In a heavily regulated space, a miscalculation by the creditor—either directly or performed by the servicer—may result in an audit, fine, litigation, or a combination thereof. Navigating this maze is challenging.

In order to mitigate this risk and complexity, servicers require precision

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and timeliness, including systems with integrity and transparency. Understanding the documentation that a servicer needs and providing it as neatly and quickly as possible helps everyone. Servicers cannot complete a review unless everything is delivered on a timely basis. Submitting incomplete and disorganized packages or ignoring information requests only delays the process. Stale data delays it further.

Rules are another important aspect of this process. The servicers must adhere to rules and guidelines promulgated by their investors. Each investor has guidelines that the servicers must follow for the application to be submitted to the investor for approval. Unexpected terms are frequently the result of these requirements. For example, a loan that is part of a securitized trust terminating in ten years cannot have a modification that outlives the trust. Many states and bankruptcy courts have programs to accommodate the modification process. They are generally governed by local rules and designed to provide order and streamline the process. It is important to follow these jurisdictional rules. Failure to do so can result in the modification process halting before it can start.

When a residential property is heading towards or in default, mortgage modifications are often the best solution for all stakeholders: debtors, creditors and the courts. It is important to keep this holistic perspective in mind and correspondingly for debtors and creditors to work collaboratively to avoid foreclosure. In the end, all involved parties can benefit. ■

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FOOTNOTES

1. https://www.jec.senate.gov/public/_cache/files/8c188465-2641-4278-af85-b61f8a677c28/subprimeliaer2007revised.pdf
2. Ibid.

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