

# THE REAL DEAL

## Mortgage servicers sucking loans dry?

*Mortgage industry milking homeowners before foreclosure, critics say*

September 29, 2008

By Alex Ulam

With housing prices declining in neighborhoods hard hit by the foreclosure crisis, the question on many real estate minds is: Why are banks and investor-controlled trusts not doing more to cut their losses by working out loan modifications?

The answer, according to some analysts, is that mortgage servicers are calling the shots. And although the servicers have a legal obligation to maximize revenue for the owners of the mortgage-backed security, critics of the industry claim that servicers' financial interests are often in conflict with the investors they are ostensibly working for.

In the last few months, the mortgage servicing industry has come under increased scrutiny, as both housing advocates and state legislators have seized upon its business practices as a problem that may be deepening the housing crisis. Just last month, Governor Paterson signed legislation intended to make the loan modification process less arduous.

Some say mortgage servicers are milking homeowners for delinquency fees, raking in more money from them either before the home reaches foreclosure or before they can catch up on payments.

One key part of the problem: homeowners who are delinquent on their loans can be a critical component of the servicer's revenue.

"I have had people in the [servicing] industry tell me that their best customer is the one who is always 30 days late," said Howard Glaser, a former official at the U.S. Department of Housing and Urban Development, and the president of the Washington, D.C.-based Glaser Group, a mortgage industry consulting firm.

"If you can keep the borrower on the hook and paying late fees, that is where the profit is in servicing," Glaser said. "Otherwise, if everybody is paying on time, there isn't a tremendous amount of profit.

"There is an element of 'suck the loan dry, and then once you have gotten everything out

of it that you can, you leave the carcass on the side of the road."

### Maximizing revenue

In many mortgage securitizations, the mortgage servicer pays for the servicing rights on a mortgage. In return for a portion of the interest on the loan, it collects mortgage payments and distributes them to the bank or the trust that owns the mortgages.

Mortgage servicers lose this source of revenue when a house goes into foreclosure. However, some analysts say keeping homeowners on the verge of foreclosure is so profitable that servicers have little incentive to make the types of loan modifications that would enable the homeowners to catch up on their payments and stay current afterwards.

"A lender would say that it is always in their interest to do modifications with borrowers and keep the cash flow coming in from the loans," said Josh Zinner, co-director of the Neighborhood Economic Development Advocacy Project, a Manhattan-based group that advocates for low-income communities. "But because of the way the securitization system is structured, it is the servicers who make these decisions. They make fees when the borrower gets behind and the fees amplify — where they don't make money is in doing loan modifications."

In addition to the profits servicers make from tacking fees onto delinquent loans, there are other disincentives for them to modify mortgages, said Ellen Harnick, senior policy counsel of the Center for Responsible Lending, a national nonprofit.

Although servicers generally get reimbursed for third-party expenses related to foreclosure, they must cover the costs of loan modification in-house. There is also often a "piggy-backed second mortgage" which, according to CRL, can make modifying difficult because the second-mortgage holder has little incentive to cooperate.

In addition, because mortgage servicers are legally mandated to maximize revenues for the trusts that own the mortgage, they fear being sued by investors if they write down the value of the loan, Harnick said.

"If the servicer simply forecloses on every single mortgage, they are doing what they always did, whereas if they modify a loan or accept a short refinance or a short sale, then they are subject to an argument about whether they properly exercised their discretion," she said. "Could they have gotten a better deal?"

### Disputing allegations

The mortgage securitization industry disputes allegations that servicers are more inclined to foreclose than to pursue loan modifications.

"People think that it is in the best interests of servicers to foreclose, but it is not," said Tom Deutsch, deputy executive director of the American Securitization Forum.

"Ultimately, the servicer loses the [standard] servicing fee, which is their source of revenue, and they have to go through the foreclosure process, which is time-consuming, and for which they do not receive reimbursement."

Deutsch said one of the biggest barriers to working out loan modifications is borrowers. Borrowers, he said, have failed to take advantage of a fast-track loan modification program that was announced by the ASF late last year.

"A number of servicers have sent out cards and letters to borrowers saying, 'Congratulations, based on our review of your files you are eligible for a fast-track loan modification — if you sign here we will freeze your interest rate at its existing rate,'" he said. "But in approximately 40 percent of the cases, the borrower doesn't respond to those letters."

Another major hurdle is that many homeowners are simply in too much debt to carry even greatly reduced mortgage payments, said Mordy Husarsky, managing director of the Brooklyn-based mortgage brokerage Fairmount Funding. So, loan modifications are simply not doable for a lot of homeowners.

"It depends how much debt servicers are going to have to write down to make it work," said Husarsky, whose firm recently sold a servicing operation that he says serviced approximately \$1 billion worth of mortgages. "Since we are talking about every single loan in foreclosure, it is an arduous task. Who is weeding out all of the borrowers to figure out exactly what it is the borrower is capable of doing? Is it faster and more efficient to foreclose, because then you have to monitor what the modification was? Will the borrower honor the agreement? What happens if they don't honor it? It is all very complex."

Also, despite recent efforts by the securitization forum to simplify the loan modification process, there is still a lot of red tape for homeowners.

"It borders on the impossible," said Charles Assini, legal counselor to Frank Padavan, New York state senator, who has been working with homeowners in Jamaica, Queens, which has been hard hit by the foreclosure crisis. "I doubt a homeowner could do this by himself or herself — just finding the right person to talk to is a monstrous task. It is frustrating because [the mortgage servicers] keep changing the personnel. You never get the same person on the phone. And then the mortgage gets sold, and you have to start all over."

### Changing the law

The legislation passed in Albany and signed into law by Governor Paterson in August holds out some promise of making the loan modification process easier.

Under the new bill, mortgage servicers will be required to notify homeowners who took out subprime or nontraditional mortgages between Jan. 1, 2003 and Sept. 1, 2008, 90 days before initiating a foreclosure proceeding. They will also have to show up to court-monitored settlement hearings with subprime homeowners facing foreclosure.

While many in the homeowner advocacy community support the legislation, it faced stiff opposition from some in the mortgage banking industry, as well as foreclosure attorneys.

"The lending community objected. They said, 'This is going to slow down our ability to foreclose,'" said Steven Alden, chair of the state Bar Association's Task Force on Mortgage Foreclosures. "The Legislature said, 'Good, that is exactly what we wanted to do.'"

Although the new law may slow the pace of foreclosures, it is not clear what impact it will have on the number of foreclosures. For one thing, while the law mandates court-supervised settlement conferences, it does not require servicers to actually modify mortgages.

For another, it doesn't address a valuable source of revenue, the onerous late fees that servicers attach to delinquent mortgage payments.

Moe Bedard, president of Loan Safe Solutions, a California-based mortgage auditing and loan processing firm, said there is so much money to be made on delinquent loans that servicers are willing to risk that they will lose servicing fees on the percentage of homes that do go into foreclosure.

"The goal is not to have the home foreclosed on," he said. "It is to rack up as many late fees as you can because of this big foreclosure mess and then save the home at the last minute, charge them 50 grand and put it on the back of the loan. You multiply that by thousands of loans that are doing this, and you see the profit that can be made."

"Again," he added, "it is a roulette theory: Some are going to pay off, and some are not."

---

This document is provided for "fair use" not-for-profit, educational purposes (and other related purposes). If you wish to use this copyrighted material for purposes of your own that go beyond "fair use," you must obtain permission from the copyright owner.