Loss Mitigation: Default Tools and Mod Opportunities

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Default products – Increase Capacity

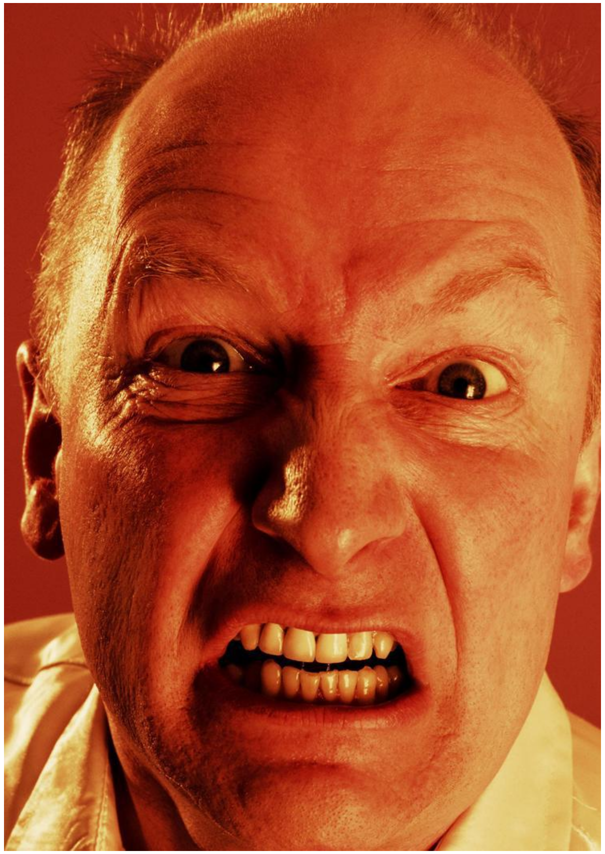
- Functionality Needed
  - Sophisticated rules – investor compliance, workout hierarchy, delegated authority
  - Analytics –on Gross income, Net Income, workout hierarchy, waterfall (amortization, rate, deferrals), NPV
  - Fully integrated with servicer's System of Record
  - Eliminates redundant data entry
  - Workflow – event driven and queuing
  - Electronic data from non-profit counselors and borrowers
  - Borrower loss mit status inquiries via web rather than inbound calls tying up Customer Service and Loss Mit
  - Document generation

Default Products- Increase Capacity and Effectiveness

- EarlyResolution suite
  - EarlyResolution
  - EarlyResolution Counseling Portal
  - ER Inquiry
  - Borrower Portal
- Others

Mods to date not working!

- High fail rates!
- Congress frustration!
- Borrower frustration!



Characteristics of Successful Mods

- Affordability
  - Housing
  - All debt
- Equity stake by borrower
  - Recidivism increases with LTV. Exponential over 120%

Characteristics of Successful Mods Using Gross Income and DTI Ratios

- Realistic housing ratios
- Look at Front End and Back End Ratios.
  - 2nd mortgage needs to be part of negotiated solution
  - No deal until borrower gets Back End Ratio below 50%
    - Warm transfer to non-profit counselor – want a holistic solution
- Gross income should be adjusted for
  - Child care allowance – self employed analogy
  - Self-employment adjustments
  - Extra-ordinary involuntary medical expenses
  - # of dependents

Characteristics of Successful Mods using Gross Income and DTI ratios

- Modify to current value and have an equity share arrangement where the borrower gets 20-25% of appreciation over current value
- Full documentation – to ensure borrower not overstating or hiding income
- If Step Rate mod, 1st step needs to be at least 5 years. Longer for borrowers on fixed income
- Investing in non-profit counseling with groups like CCCS Atlanta is worth the investment

NPV Models Lack Consistency and Transparency

NPV Mod Issues

- Often the mod is better execution than REO
- However, most mod NPV's are overstated
  - Mods that fail –
    - % of fails is usually understated
    - Severity of fails is usually understated
  - Mods that perform
    - Mods without principal deferment do not take into consideration that **payoff is going to be a short sale**
  - Many REO NPV's are understated
    - Probability of REO is not 100%
- NPV of Shared Appreciation mod is = to rate reduction/term extension mod using realistic assumptions!!

Impact of Proposed Bankruptcy Cram-down Legislation

- More mods will be done outside of bankruptcy
  - More principal “forgiveness” or “deferrals with shared appreciation” mods
  - Safe harbor
  - Back End Ratio still an issue
- Bankruptcy/cram-down mods
  - Lower recidivism – addresses both equity stake and all debt
- Servicing advances on FHA loans needs to be addressed/resolved

Conclusion

- Default tools can significantly increase capacity
- Mods need to address total affordability and equity stake
- Gross Income and DTI % approach makes sense with certain adjustments
- Most NPV models overstating mod benefit over REO
- Shared Appreciation mods make economic sense
- Bankruptcy legislation is a “net” positive

Questions?

