AN EXPLORATION OF SUCCESSFUL DEFAULT MANAGEMENT STRATEGIES FOR AFFORDABLE HOME LOANS

by

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Approved by:

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ADVISOR
Introduction

Since the 1990s, major players in the mortgage industry, including Fannie Mae and Freddie Mac, have strived to increase homeownership opportunities for low- and moderate-income borrowers. In order to address this opportunity, many lenders have developed affordable loan products targeted to this demographic. At the same time, there has been renewed focus on default management. This is especially important for low- and moderate-income borrowers given that they are more likely to experience delinquency when faced with an unexpected expense or change in income. It is critical for the industry to understand how best to manage these delinquencies in order to support the homeownership initiative and to limit investor losses.

This paper seeks to identify default management best practices. For the purposes of this paper, default management and loss mitigation both refer to servicing after the first missed payment in order to cure the delinquency and/or reduce potential losses associated with a foreclosure. The first portion of the paper consists of a literature review that discusses some of the successful strategies employed in the industry. The second portion of the paper examines the evolution of servicing in Self-Help’s Secondary Market Program. Self-Help is a non-profit community development financial institution that has partnered with The Ford Foundation, Fannie Mae and participating lenders to create a secondary market for non-conforming mortgage loans. Self-Help’s wealth of experience with affordable mortgages provides valuable insight into successful default management strategies for CRA loans. The paper concludes with an examination of the operations and strategies of Self-Help’s servicers in order to help explain performance discrepancies and highlight best practices.

Literature Review

Foreclosure prevention efforts benefit borrowers by keeping them in their homes and benefit investors by limiting losses. However, it wasn’t until the late 1990s when Fannie Mae, Freddie Mac and HUD made foreclosure prevention a top priority. This new focus spurred dramatic improvement in default management strategies. The industry embraced a variety of loss mitigation techniques that include the following:

Repayment Plan: The delinquent borrower resumes regular monthly payments along with an additional specified monthly amount that will bring the loan current over a period of up to 12 months.

Short Term Forbearance Plan: The servicer suspends up to three payments or reduces payments for up to 6 months. This is followed by a repayment plan.

Long-Term Forbearance Plan: The servicer suspends or reduces payments for 4 to 12 months. At the end of the forbearance period, the borrower must enter into a repayment plan that will bring the loan current within 12 months.
**Loan Modification:** This involves a permanent change to the terms of the mortgage to make mortgage payments affordable to the borrower. Changes include reducing the interest rate, extending the loan period, or forgiveness of loan payments. In addition, missed payments and other costs can be recapitalized into the loan amount.

**Partial Claim Workout:** The FHA loan loss mitigation program offers this alternative in which a lender advances funds to the servicer to bring the loan current and the borrower enters into a subordinate mortgage with HUD.

**Short Sale:** If the borrower cannot afford to stay in the home, this option allows the borrower to sell the home for an amount less than the full payoff of the loan. In exchange, the servicer then releases the borrower from the lien. The investor incurs the losses of the short sale but avoids eviction, foreclosure and liquidation expenses.

**Deed in Lieu of Foreclosure:** If the borrower is unable to meet the terms of the mortgage, he or she can deed the property back to the investor in exchange for a release from the mortgage obligation. This outcome is less damaging to a borrower’s credit. The investors still incurs losses and expenses associated with liquidation, but avoid the time and costs associated with foreclosure and eviction.

Widespread adoption of these strategies has had dramatic impact. In 1996, approximately 30% of 60+ delinquent loans at Fannie Mae and Freddie Mac cured via home retention workout plans. By 2002, it had increased to 50%.

Furthermore, evidence suggests that workouts are effective at helping delinquent borrowers avoid foreclosure. Amy Cutts and Richard Green analyzed 148,050 Freddie Mac loans that became 60-, 90-, or 120-days delinquent between January and September 2001. Each loan was tracked for a period of 18 months after entering the sample. Researchers defined a cured loan as any loan that either fully reinstated, was modified, was assumed by a new borrower or paid off, and a failed loan as any loan that resulted in the loss of the home through foreclosure or a foreclosure alternative. The study revealed that being in a repayment plan lowered the probability of failure by 68% for low-to-moderate income borrowers and 80% for non-low-mod borrowers.

**Servicing Technology**

Improvements in default management are partially attributable to advances in servicing technology. In addition, these new technologies have increased productivity and driven down servicing costs. It was the success of automated underwriting software using credit-scoring models that led to advances in mortgage servicing and loss mitigation systems.

In the 1990s, credit-scoring based servicing tools were introduced. These tools use credit scoring technology and patterns in borrowers’ payment histories to rank the risk levels of delinquent borrowers. In other words, the models identify the loans that are likely to cure on their own versus those that need servicer intervention to avoid foreclosure. This allows servicers to prioritize collection calls and direct resources towards loans that pose a risk of losses. This prioritization allows for earlier intervention with high-risk loans.

Other technologies were developed to structure workouts for delinquent borrowers. Given a variety of inputs, the technology determines an optimal workout solution for delinquent borrowers. The hope is that this technology increases the chances that workouts will keep borrowers in their homes.

Freddie Mac and Fannie Mae are two of the largest servicing technology providers.

Freddie Mac launched Early Indicator in 1997. The software application uses borrower payment histories, an estimate of the current market value of the property, local-market economic data and other borrower and mortgage characteristics to risk rank delinquent loans. If a borrower has missed a single payment, the software system assigns a collection score ranging from 000/F to 099/A (highest risk) that indicates the probability that the borrower will miss their second payment. If the loan is due for more than one payment, Early Indicator assigns a loss mitigation score ranging from 101/F to 400/A (highest risk) that indicates the likelihood of the loan producing a loss. The system is currently able to score all loans including conventional, FHA/VA and subprime loans.

Freddie Mac’s Workout Prospector, which launched in 1996, uses automatic property valuations and borrower financial data to analyze foreclosure alternatives for delinquent borrowers and helps servicers choose the optimal option.

Freddie Mac introduced EarlyResolution in 2000. It is a web-based collections tool designed to help counselors work more effectively with delinquent borrowers, earlier in the delinquency process. The software provides counselors with scripted questions to obtain information from borrowers over the telephone and then uses the borrower responses to identify appropriate workout strategies. In 2002, Robert Caruso, senior vice president of loan servicing at Wells Fargo Home Mortgage, stated that its foreclosure rate dropped by 60% after the introduction of the EarlyResolution software.3

Fannie Mae’s suite of default management software includes Risk Profiler and Workout Profiler. Risk Profiler assigns scores that indicate which delinquent loans are likely to be resolved on their own verses those that require servicer intervention. Workout Profiler is a model that uses borrower’s financial information, property market values and payment histories to help servicers identify optimal workout solutions for delinquent borrowers. Many servicers utilize Workout Profiler via the Home Saver Solutions Network, a web-based application that allows servicers to submit Fannie Mae loss mitigation workout cases via the internet.

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The increase in workouts since 1997 suggests that the software has been effective. Freddie Mac settled 3400 workouts in 1994, 5100 in 2000 and more than 6300 in 2001.  

Fannie Mae’s results are also impressive. Fannie Mae workouts rose from 12,065 in 1997 to 21,727 in 2002. During the same time period, workout ratios (percent of delinquent loans worked out) rose from 35% to 53%. Finally, of the 21,727 borrowers who received a workout, over 90% were able to avoid foreclosure in 2002. 

These positive results have not been limited to the conventional market. FHA has also experienced dramatic increases in workouts after instituting a loss-mitigation program in 1997. Despite rising delinquency rates, foreclosure rates have remained “fairly steady”. Joe McClosky, director of single-family asset management from HUD stated, “The purpose of the government loan program is to provide a lending opportunity to low- to moderate-income borrowers. Because of that, we have historically -- and logically -- had higher default rates than the conventional market. That’s our societal purpose, and the consequence is a higher default rates. There has been an increase in the delinquency rate overall for the last several years, but we have not seen a commensurate rise in foreclosures.”

Between 1997 and 2002, FHA loss mitigation claims rose from 8000 loans to 73,000 loans. “In 2002, approximately 94% of the claims FHA paid in loss mitigation kept the borrowers in their homes.”

**Pre-Purchase Counseling**

HUD, Fannie Mae, Freddie Mac, lenders, mortgage insurers and state housing agencies began actively promoting pre-purchase counseling and education in the mid-1990s in order to address rising defaults and foreclosures. The goal of pre-purchase counseling is to prepare families for homeownership by explaining the home buying and financing process, discussing home maintenance and repair issues and educating the borrower about budgeting, money management and default and foreclosure prevention. The hope is that counseling will help prevent borrowers from taking on a larger mortgage than they can afford and help them avoid delinquencies down the road. There are currently a wide variety of counseling programs including classroom, individual counseling, home study and telephone. Certain lenders and insurers require pre-purchase counseling, especially for borrowers in certain loan programs.

In 2001, Freddie Mac published the first empirical study of the effects of pre-purchase counseling programs. The research examined close to 40,000 loans purchased by Freddie Mac under its Affordable Gold program between 1993 and 2000. In 1993, Freddie Mac began requiring that each Affordable Gold loan “have at least one qualifying

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borrower that receives pre-purchase homeownership counseling.” The control group consisted of the 3% of Affordable Gold loans that were exempt from the pre-purchase counseling due to the fact that at least one co-borrower had previously owned a home, the LTV was less than 95% or borrowers had cash reserves equal to or greater than two monthly mortgage payments.

The research revealed that after controlling for borrower, loan and property characteristics, borrowers that received pre-purchase counseling had, on average, a 19% lower 90-day delinquency rate. The effectiveness varied across the types of counseling programs. Individual programs led to a 34% delinquency reduction, classroom resulted in a 26% reduction and home study reduced 90-day delinquency by 21%. Telephone counseling had no effect. In addition, there was no measurable difference among different counseling providers.

**Foreclosure Prevention Counseling**

Credit counseling for delinquent borrowers is another loss-mitigation strategy. This strategy generally involves servicers, lenders and/or insurers contracting with third-party counseling agencies. The counselors contact the borrowers after delinquency to provide budgeting and money management advice. Counseling provides two primary benefits. First, a call or letter from a counseling agency is likely much less threatening than the same from a servicer. Thus, counselors may be the first point of contact with borrowers that servicers have been unable to reach. In addition, providing budgeting advice can sometimes help borrowers find a way to resume their mortgage payments.

Data suggests that foreclosure prevention counseling is effective. However, there have been no controlled studies done that provide conclusive evidence. Between July 1991 and July 1998, the Mortgage Foreclosure Prevention Program provided intensive counseling and in some cases financial assistance to 1,700 borrowers in Minnesota. The average homeowner was four months behind on their mortgage payments. Approximately 50% of the homeowners that received counseling were able to reinstate their mortgage (841). It is important to note that the program provided emergency loans to 57% (483) of the homeowners that reinstated. Two years after reinstatement, 50% of those that were reinstated were still current.

GMAC Residential Funding Corp. began providing free credit counseling to delinquent borrowers in 2001. Since then, about 25,000 borrowers have used the program. Each session costs about $100. Servicers refer borrowers that reach the 45th day of delinquency to credit counselors. Fifty percent of the borrowers were able to bring their loans current within six months.

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Self-Help’s Secondary Market Program

Self-Help is a non-profit community development financial institution based in Durham, NC. In 1998, Self-Help teamed up with Fannie Mae and the Ford Foundation to offer a national secondary market for non-conforming home loans. The goals of the project are to increase mortgage lending to low- and moderate-income borrowers and to demonstrate the credit-worthiness of these loans.

Under this partnership, Self-Help purchases affordable mortgages from participating lenders that would otherwise be excluded from the secondary market due to their perceived higher risk characteristics including high LTV, lower credit scores, higher debt to income ratios and lack of mortgage insurance coverage. Fannie Mae purchases the loans that Self-Help acquires with Self-Help retaining full recourse. This was initially made possible by a $50 million grant from The Ford Foundation to underwrite a large portion of this credit risk. As of September 2004, Self-Help's Secondary Market Program has provided financing for $3.145 billion in affordable mortgage loans.

Philosophy

Self-Help’s primary goal in servicing is to help borrowers stay in their homes. This supports Self-Help’s overall mission of raising homeownership levels for low- and moderate-income people. It also makes financial sense. On average, Self-Help loses $17,500 on every loan that goes to foreclosure. Consequently, Self-Help places great emphasis upon loss mitigation techniques such as repayment plans, loan modifications, etc. This is in line with the mortgage industry overall. Both Fannie Mae and Freddie Mac have encouraged servicers to pursue loss mitigation strategies and have developed software than enables servicers to efficiently assess loss mitigation alternatives.

Where Self-Help’s philosophy differs from industry strategy is in flexibility and timing. Self-Help loans money to borrowers that have incomes at or below 80% AMI, require minimal down payments and no borrower reserves. Consequently, any unexpected change in income or expense can result in delinquency. Furthermore, once behind, they do not have the reserves to recover quickly. For this reason, Self-Help is more comfortable with allowing borrowers more time to recover from hardship. Self-Help instructs servicers to do whatever they can to avoid foreclosure. For example, if a borrower is 90+ days delinquent, able to resume monthly payments but unable to make back payments, the servicer should review the loan for modification. Or if this same borrower is able to pay small portions of back payments, this should be continued even if it means the borrower will be over 90 days delinquent for a extended period of time.

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short, Self-Help is willing to take on the risk associated with extended delinquency in order to give the borrowers more opportunity to save their homes and avoid foreclosure.

History

When Self-Help’s secondary market program began, Self-Help was not directly involved in the servicing. Dave Bucholz, then the director of secondary markets, indicated “servicing was on the radar screen as something that would need to be addressed, but the initial focus was identifying lenders and building the program infrastructure.” As a result, lenders serviced the loans according to Fannie Mae guidelines without oversight from Self-Help.

After about one year, Self-Help hired an employee to oversee servicing. However, it was a couple of years before Self-Help had developed their own philosophy, which allowed them to become more active in the servicing arena. They began conducting audits and meeting with servicers to further their understanding. After three years, Self-Help began to focus on servicing diligently. This was prompted by the fact that certain lenders had much higher loss rates than others. Self-Help conducted a survey of their servicers in 2002 and was surprised to find significant variations in servicing policies. They had been relying on servicers to follow Fannie Mae guidelines, but found that certain guidelines are broad and open to interpretation. The survey highlighted certain servicing behaviors that did not mesh with Self-Help’s philosophy. For example, some servicers were referring delinquent loans for foreclosure prematurely. Others were not aggressive enough with phone calls and letters. Transferring the servicing to a specialized servicer was considered. However, it was ultimately dismissed due to the fact that lenders would likely be unwilling to sell loans to Self-Help if they would not be able to maintain the revenue associated with servicing. The only other alternative was to build relationships with the existing servicers.

In July 2002, Mary Holder, Self-Help’s current manager of servicing and loss mitigation, was brought in. Her first priority was to educate the servicers about Self-Help’s role in the secondary market program. At that time, many servicers were under the impression that the loans belonged to Fannie Mae and were not even aware of the connection with Self-Help. The servicers were educated about Self-Help as an organization and it’s mission. In addition, servicers were made aware of the fact that Self-Help holds recourse on the loans, which clearly impacts decision-making regarding the loans.

Today, Self-Help is directly involved in servicing. Self-Help has established servicing guidelines and is very active in the loss mitigation process. In fact, every loss mitigation case that impacts collateral must be approved by Self-Help.

Counseling

Counseling is an important element in the servicing of Self-Help loans. Self-Help contracts with a third party agency to contact borrowers at the 45th day of delinquency.
The role of the counselor is to provide financial education regarding budgeting and cash flow analysis and to help the borrower develop an action plan. However, it is not the counselor’s role to serve as a mediator between the borrower and the servicer. Counselors explain that servicers are there to help them and it is important to communicate with the servicer to set up a workout plan.

Self-Help initially contracted with a credit counseling service in November of 2000. The pilot program was established with a single lender/servicer. A primary goal of the program was to provide a less intimidating way to reach out to delinquent borrowers that may be hesitant to work with servicers. However, Self-Help soon discovered that the agency was still not reaching the desired number of borrowers. Self-Help attributed this to the fact that this particular agency was used to working with borrowers that approached the agency voluntarily and were consequently not set up to effectively meet Self-Help’s needs.

In 2002, management decided to transfer the counseling to CCCS in San Francisco. This agency was arranged more like a call center, which was a more appropriate model for the Self-Help contract. In addition, it was on the west coast. The time difference allowed the counselors to contact Self-Help borrowers (the majority east of the new location) at times when they were more likely to be home.

Self-Help has slowly added servicers to the counseling service. The majority were added based on high delinquency rates and/or borrower need due to economic conditions or lower incomes. Five servicers currently participate in the program.

**Policies**

Self-Help’s servicing guidelines mimic the evolution of their servicing philosophy. The Self-Help Secondary Market Community Advantage Servicer Handbook in use in 2001 provided some background information regarding the Self-Help secondary market program and general functional guidelines. However, the guidelines did not stray far from Fannie Mae’s. For example, the guide directs the servicer to “follow Fannie Mae requirements for foreclosure unless indicated otherwise, herein.” The foreclosure guidelines did not include any mention of specific timelines to follow.

As previously stated, Self-Help conducted a servicer survey in 2002 and found that policies varied widely from servicer to servicer. The day of delinquency when servicers were sending breach letters ranged from the 31st day to the 91st day. Referral to the foreclosure department ranged from the 60th day to the 121st day. And referral to the foreclosure attorney occurred anywhere between the 61st day to after the 121st day. Self-Help discovered that servicers were referring loans to foreclosure based on the following schedules:
Table 1: Secondary Marketing Report of Foreclosure Referrals By Servicer, September 2002

<table>
<thead>
<tr>
<th>Servicer*</th>
<th>Breach Letter</th>
<th>F/C Dept. Referral</th>
<th>Attorney Referral</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>32nd day</td>
<td>70th day</td>
<td>75th day</td>
</tr>
<tr>
<td>B</td>
<td>65th day</td>
<td>95th-105th day</td>
<td>95th-105th day</td>
</tr>
<tr>
<td>C</td>
<td>45th day</td>
<td>75th day</td>
<td>82nd day</td>
</tr>
<tr>
<td>D</td>
<td>High Risk = 31st – 45th day</td>
<td>High Risk = 61st – 75th day</td>
<td>High Risk = 61st – 75th day</td>
</tr>
<tr>
<td></td>
<td>Low Risk = 61st-75th day</td>
<td>Low Risk = 91st-105th day</td>
<td>Low Risk = 91st-105th day</td>
</tr>
<tr>
<td>E</td>
<td>65th day</td>
<td>95th day</td>
<td>110th day</td>
</tr>
<tr>
<td>F</td>
<td>32nd day</td>
<td>99th day</td>
<td>105th day</td>
</tr>
<tr>
<td>G</td>
<td>35th day</td>
<td>65th day</td>
<td>After 65th day</td>
</tr>
<tr>
<td>H</td>
<td>61st day</td>
<td>91st day</td>
<td>After 91st day</td>
</tr>
<tr>
<td>I</td>
<td>65th day</td>
<td>120th day</td>
<td>After 120th day</td>
</tr>
<tr>
<td>J</td>
<td>75th day</td>
<td>105th day</td>
<td>108th day</td>
</tr>
<tr>
<td>K</td>
<td>35th day</td>
<td>65th day</td>
<td>After 65th day</td>
</tr>
<tr>
<td>L</td>
<td>91st day</td>
<td>121st day</td>
<td>After 121st day</td>
</tr>
<tr>
<td>M</td>
<td>91st day</td>
<td>121st day</td>
<td>After 121st day</td>
</tr>
<tr>
<td>N</td>
<td>31st day</td>
<td>61st day</td>
<td>91st day</td>
</tr>
<tr>
<td>O</td>
<td>35th day</td>
<td>90th day</td>
<td>After 90th day</td>
</tr>
<tr>
<td>P</td>
<td>61st day</td>
<td>91st day</td>
<td>After 91st day</td>
</tr>
</tbody>
</table>

Source: Self-Help  * Servicers names are not used in order to protect anonymity.

The servicing handbook was revised in January 2003. It contains more specific guidelines in addition to a variety of forms and checklists. It also contains more information regarding best practices. Again, the guidelines do not stray far from Fannie Mae standards. The following guidelines are highlighted:

Table 2: Self-Help Servicing Guidelines, January 2003 Revision

<table>
<thead>
<tr>
<th>Event</th>
<th>Action Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between the 7th and 10th Day of Delinquency</td>
<td>Make Telephone Contact &amp; Send Payment Reminder Notice</td>
</tr>
<tr>
<td>15th Day of Delinquency</td>
<td>Send Late Payment Notice</td>
</tr>
<tr>
<td>By the 20th Day of Delinquency</td>
<td>Send Letter</td>
</tr>
<tr>
<td>30th Day of Delinquency</td>
<td>Offer Early Delinquency Counseling</td>
</tr>
<tr>
<td>31st Day of Delinquency</td>
<td>Send Letter</td>
</tr>
<tr>
<td>45th Day of Delinquency</td>
<td>Schedule Early Delinquency Counseling</td>
</tr>
<tr>
<td>50th Day of Delinquency</td>
<td>Send Loss Mitigation Alternatives Letter</td>
</tr>
<tr>
<td>61st Day of Delinquency</td>
<td>Send Breach/Demand Letter (Continue Loss Mitigation)</td>
</tr>
<tr>
<td>91st Day of Delinquency</td>
<td>Breach Letter Expires. Refer to FC Department. (Continue Loss Mitigation)</td>
</tr>
<tr>
<td>105th Day of Delinquency</td>
<td>Refer Loan to FC Attorney (Continue Loss Mitigation)</td>
</tr>
</tbody>
</table>

Ms. Holder indicated that the most important guideline is that the breach letter must not be sent prior to the 61st day of delinquency. A loan cannot be referred to foreclosure before the expiration of the breach letter, 30 days after it is sent. Consequently, sending the breach letter after the 61st day of delinquency guarantees that a loan will not be referred to foreclosure before the 91st day. Although the Self-Help servicing handbook indicates that a loan should not be referred to a foreclosure attorney before the 105th day, this is not a strict requirement but more of an estimate of the time it takes for an average foreclosure department to prepare the paperwork that is required to refer the loan to an attorney.

Mary Holder is currently working on a new servicing handbook that will be released in 2005. It is a clear departure from the previous handbooks in that it focuses more heavily on Self-Help’s mission and servicing philosophies rather than detailed functional guidelines. She feels that servicers “already know the nitty gritty details” in terms of how to service loans. It is more important to impart Self-Help’s differences compared to other investors. However, the foreclosure referral process is one area where guidelines are still explicit.

Table 3: Self-Help Servicing Guidelines, 2005

<table>
<thead>
<tr>
<th>Day of Delinquency</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>16th Day</td>
<td>Send Letter – 1 Payment Due Plus Late Charge</td>
</tr>
<tr>
<td>31st Day</td>
<td>Send Letter – 2 Payments Due</td>
</tr>
<tr>
<td>45th Day</td>
<td>Send Notice of HUD Counseling Agencies or Notice of SH counseling agency referral</td>
</tr>
<tr>
<td>50th Day</td>
<td>Send Loss Mitigation Solicitation Letter</td>
</tr>
<tr>
<td>61st Day</td>
<td>Send Breach Letter – 3 Payments Due</td>
</tr>
</tbody>
</table>

Based on the outline above, the breach letter should not be sent any sooner than the 61st day of delinquency; therefore loans less than 91 days delinquent should not be referred to foreclosure.

Source: Self-Help Ventures Fund Loans Servicing Handbook, to be released 2005

However, there is a subtle but meaningful shift. The 2003 handbook indicates that loans should be referred to foreclosure on the 91st day. The 2005 handbook states that loans should not be referred to foreclosure before the 91st day. This discrepancy grants the servicer more discretion and supports Self-Help’s philosophy that servicers should exhaust efforts to help the borrower recover before beginning the foreclosure process.

Today, there are three primary differences between Self-Help and Fannie Mae guidelines. First, Self-Help requires servicers participating in the counseling program to send borrowers a referral to the counseling agency.

Second, Fannie Mae Risk Profiler guidelines for loans with a low Risk Profiler score indicate that the breach letter should be sent by the 62nd day of delinquency. This matches Self-Help’s guideline. However, loans with moderate or high Risk Profiler score...
require that “the breach letter should be sent by the 35th day of delinquency if the
servicer has been either unable to contact the borrower or arrange a satisfactory
repayment plan, otherwise low risk.”13 By law, foreclosure proceedings can begin 30
days after the breach letter is sent. Thus, borrowers that are sent breach letters on the 35th
day can have foreclosure proceedings begin a soon as the 65th day of delinquency. The
loss mitigation letter is mailed on the 50th day, which is only 15 days prior to the
expiration of the breach letter. This does not allow sufficient time for loss mitigation
efforts. While servicers can pursue loss mitigation with borrowers after referral, the
referral itself results in attorney fees, which reduce the likelihood of a successful workout
to the delinquency.

Finally, Self-Help requires a borrower contribution in all loan modification cases. In
order to approve a loan modification, Self-Help requires that the borrower pay for the
$500 servicers modification fee, plus any other fees including legal fees, foreclosure fees,
property inspection fees, etc. According to Mary Holder, these fees can be as much as
$3000. Self-Help views this upfront payment as a sign of good faith and believes that it
will help prevent a similar situation in the future. In contrast, Fannie Mae is open to
paying the balance of these fees that the borrower cannot afford or capitalizing all or part
of the fees as into the modified mortgage amount.

Quality Control

Mary Holder diligently monitors the servicers’ performance. Each month, she receives a
delinquency report for each servicer that contains a list of all loans that are over 30 days
delinquent. In most cases, the reports have codes that indicate the status of the loan:
workout, loss mitigation review, bankruptcy, referred to foreclosure and REO. Based on
this information, she tracks each loan that is 90+ days delinquent. There are four things
in particular that she checks for:

1) If the loan is seasoned and not in a workout or loss mitigation review status, she
solicits a loss mitigation review.
2) She looks for cases where the servicer has referred a loan to foreclosure
prematurely.
3) She checks to see that the servicers are not approving loan modifications without
Self-Help’s approval.
4) She looks for loans that have gone to foreclosure sale to ensure that Self-Help has
received the notice of acquisition.

In addition, Mary uses this information to create a delinquency report that tracks the
number of loans in 30, 60 and 90-day buckets over time for each servicer. If she notices
spikes that are not reflected in industry wide trends, she pursues the matter with the
servicer.

13 Fannie Mae Announcement 03-04, Amends these Guides: Servicing, Expansion of Risk Profiler, May 1,
2003.
Finally, Mary believes that workouts need human review. Consequently, she reviews every loss mitigation case that impacts collateral. Servicers provide her with the necessary information to make approval decisions on loan modifications. Often times, this information consists of modification proposals generated by workout software programs. Mary finds that she makes changes to a large percentage of them. For example, some software systems will automatically deny a loss mitigation case if there is a deficit (expenses exceed income). In this situation, Self-Help refers the borrower to default counseling. Counselors will be able to verify that the information the borrower provided is accurate (some borrowers inflate numbers to prove hardship or broadly estimate numbers) and also provide suggestions on how to reduce non-priority debt. After these adjustments, Self-Help is able to approve a modification and keep the borrower in their home.

**Results**

**Delinquencies & Losses**

Self-Help’s 90+ delinquency rates have been rising fairly steadily since the first quarter of 2001. As one might expect, Self-Help’s 90+ delinquencies are significantly higher than industry averages for prime loans\(^{14}\). Until recently, Self-Help loans outperformed the sub-prime sector. However, subprime rates began to drop in the fourth quarter of 2003 and in the second quarter 2002, Self-Help’s 90+ delinquency rates surpassed sub-prime rates for the first time.

Figure 1: 90+ Delinquency Rates for Prime, Subprime and Self-Help Loans

Despite higher delinquencies, Self-Help’s loss incidence is low. As of September 2004, Self-Help had purchased 35,690 loans, yet only 287 loans had defaulted. In other words only 0.76% of Self-Help’s loans have foreclosed since the inception of the program. In contrast, the Mortgage Bankers Association reports that the industry average for foreclosure inventory at the end of second quarter 2004 is 1.16%.15

Table 4: Self-Help Loss Incidence as of September 2004

<table>
<thead>
<tr>
<th># Loans</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Loans Purchased</td>
<td>37,690</td>
</tr>
<tr>
<td>Total Defaults</td>
<td>287</td>
</tr>
<tr>
<td>Default Incidence</td>
<td>76 bp</td>
</tr>
</tbody>
</table>

Source: Delinquency/Loss Incidence & Severity presentation by Tracy Cox, Financial Analyst for Self-Help on 12/9/04

Loss Mitigation Efforts

Self-Help’s loss mitigation efforts have generated positive results. To date, 86% of borrowers that were referred to counseling are still in their homes one year later. The following is a breakdown of loan performance post counseling for all Self-Help borrowers that were referred to counseling:

Figure 2: Loan Performance Post Counseling

Source: Self-Help Loss Mitigation presentation by Mary Holder, Servicing & Loss Mitigation Manager for Self-Help on 12/9/04

Furthermore, Self-Help’s cure rates are impressive. For loans purchased on or before June 2003, only 2% of delinquencies have ended in foreclosure.

Figure 3: Outcomes of Delinquencies for Self-Help Loans Purchased as of June 2003

![Outcomes of Delinquencies](image)


**Servicer Performance**

Despite the positive performance of Self-Help’s portfolio to date, evidence suggests that some of Self-Help’s servicers are better at default management than others. As part of their ongoing analysis of the Self-Help portfolio, Michael Stegman, Roberto Quercia and Walter Davis examined the outcomes of loans once they became at least 30 days past due. Each 30-day delinquency and its outcome (cured, defaulted – progressed to 90-day delinquency, or remained delinquent) were deemed a “30-day delinquency spell”. The sample consisted of all 30-day delinquency spells that occurred between September 1998 and January 2003 for loans that were purchased by Self-Help prior to January 1, 2003.

Table 5: Outcomes of 30-Day Delinquencies by Lender

<table>
<thead>
<tr>
<th>Lender</th>
<th># Of Delinquencies</th>
<th>% Cured</th>
<th>% 90-days delinquent</th>
<th>% 30-60 days delinquent</th>
<th>% Terminated, 30-60 days delinquent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender 1</td>
<td>875</td>
<td>75.7%</td>
<td>20.5%</td>
<td>3.9%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Lender 2</td>
<td>2099</td>
<td>86.8%</td>
<td>11.8%</td>
<td>1.5%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Lender 3</td>
<td>1,632</td>
<td>86.6%</td>
<td>12.4%</td>
<td>1.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Lender 4</td>
<td>1198</td>
<td>83.4%</td>
<td>15.4%</td>
<td>1.2%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Lender 5</td>
<td>1161</td>
<td>73.8%</td>
<td>24.7%</td>
<td>1.5%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>
The researchers created a model to “identify predictors of the likelihood that a given delinquency will be cured, or worsen and go into default.” The model included dummy variables for each of the seven largest servicers and control variables describing loan characteristics, borrower characteristics and macroeconomic conditions. It revealed that 30-day delinquencies for Lenders 1, 5 and 6 are “significantly less likely to cure than they are for other lenders. In contrast 30-day delinquencies for Lenders 3 and 7 are “significantly more likely to cure in comparison with other lenders.”

**Pre-Interview Rankings**

In order to better understand what is driving these servicer performance discrepancies, I asked Mary Holder to discuss her experience with each of the seven lenders. I also added an additional lender to the group, Lender 8. Throughout our conversations, Ms. Holder raised five issues that impacted servicer performance above and beyond loan and borrower characteristics:

- Personnel: Is the loss mitigation department adequately staffed? Is the staff adequately experienced?
- Identification: Can the servicers identify loans as belonging to Self-Help?
- Investor Policies: Is the staff familiar with Self-Help’s servicing policies?
- Systems: Does the lender’s system provide adequate and correct information?
- Loss Mitigation Review: Do delinquent loans receive adequate attention from the loss mitigation department? Does the servicer forward an appropriate number of loss mitigation cases to Self-Help for review given the size and delinquency of the portfolio?

After our conversations, I created a rating system that ranks each of the lenders on each of these attributes. Each lender received a score of 1 (good) or 0 (poor) in each of the five areas. Thus, the maximum score for any given servicer is 5 and the minimum is zero. Unless Ms. Holder mentioned a particular issue, I assumed that the servicer was doing an adequate job in that particular area and, thus, assigned a score of 1.

**Lender 1**

Lender 1 maintains decent delinquency ratios. However, Self-Help does not receive nearly the number of loss mitigation cases that they should given the number of foreclosures. This is especially troubling because Lender 1 services more seasoned loans and therefore should have more success with loss mitigation. Self-Help believes that this is a result of Lender 1 being short staffed. There is currently only one person assigned to loss mitigation and Self-Help is not the only investor that this person manages. Furthermore, Self-Help does not receive the number of loss mitigation cases that it would
expect given the size and delinquency of the portfolio. The concern is that the lack of personnel is affecting the borrowers’ ability to receive assistance. This has been a long-term problem. In 2003, SH had to send an email to Lender 1’s servicing manager regarding the lack of attention.

<table>
<thead>
<tr>
<th></th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender 1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>3</td>
</tr>
</tbody>
</table>

**Lender 2**
Lender 2 is a great servicer. They are good about submitting loss mitigation cases to Self-Help. In short, Self-Help has no issues with Lender 2.

<table>
<thead>
<tr>
<th></th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
<th>Total</th>
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<tr>
<td>Lender 2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

**Lender 3**
Three different servicers manage the loans purchased from Lender 3:

*Servicer A:* Servicer A is a great servicer. They have low delinquency ratios and a low foreclosure rate. They have never had a loss mitigation case, which suggests that they have effective early intervention strategies. In short, they are able to address delinquencies before they become serious.

<table>
<thead>
<tr>
<th></th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td>Lender 3A</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

*Servicer B:* Servicer B took over servicing from another servicer approximately one year ago. During this year, they have experienced growing pains. Some concerns have been Servicer B’s associates’ lack of understanding of Self-Help’s policies and their troubles in determining which borrowers were good loss mitigation candidates versus borrower that were not. Furthermore, Servicer B was reviewing and denying loss mitigation cases without Self-Help’s approval. Despite these issues, Servicer B has been receptive to working with Self-Help. Servicer B recently appointed a new associate to the Self-Help account. This person is communicating with Self-Help on a regular basis and has already sent 4-5 loss mitigation cases to Self-Help in the last two months for review.

(Despite this servicer’s recent improvement, I assigned this servicer a personnel score of zero. It sounds like Servicer B’s loss mitigation associates during this past year were new and inexperienced. Their prior lack of adherence to Self-Help’s policies also resulted in a policy score of zero.)
Servicer C: Servicer C is servicing the oldest loans that Self-Help purchased from Lender 3. The loans are more seasoned which should allow for more success with loss mitigation efforts. (Borrowers have built up more equity in their homes, and thus have more to lose in a foreclosure.) However, Servicer C is not pursuing loss mitigation strategies as aggressively as Self-Help would like. In addition, the loss mitigation cases that Servicer C has pursued have not been forwarded to Self-Help for approval. For example, Servicer C’s accounting department just notified Self-Help about a loan that they modified in December 2003. Self-Help partially attributes this to their inability to identify Self-Help loans in their system. Another contributing factor may be that the servicing keeps switching locations. Self-Help is planning on setting a cut-off period for post approval requests, which will force Servicer C to repurchase any loan that is modified without Self-Help’s approval.

<table>
<thead>
<tr>
<th>Lender 3B</th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
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</thead>
<tbody>
<tr>
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<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
</tbody>
</table>

Lender 4
Initially, Lender 4 had trouble forwarding their loss mitigation cases to Self-Help for review. The problem was that Lender 4’s system could not identify Self-Help loans. Self-Help finally provided Lender 4 with an ultimatum. Self-Help notified Lender 4 that they would not support any loss mitigation cases that were approved by Lender 4 without Self-Help’s review after April 2004. This would require Lender 4 to repurchase any loans that met this criterion. Since then, Lender 4 has made remarkable improvement. They can now identify Self-Help loans and have been submitting loss mitigation cases to Self-Help for approval. However, Self-Help still does not receive that number of cases that they would expect given the size and delinquency of the portfolio. They have a great staff and provide all the adequate information so that approvals are very efficient.

(I assigned a score of zero for both identification and policy adherence because their improvement in both areas has only been recent. The bulk of the servicing history occurred when both of these areas were inadequate.)

<table>
<thead>
<tr>
<th>Lender 3C</th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
</tbody>
</table>

Lender 5
Self-Help has a unique contract with Lender 5 that requires Lender 5 to repurchase any loan that does not pass a file review. In addition, under Self-Help’s limited indemnity policy, lenders are required to repurchase loans that become seriously delinquent before
the borrower has made 9-12 months of clean, consecutive payments. Any loan that fails a file review or is covered under limited indemnity is lender recourse, which means that any loss mitigation work is done internally and not forwarded to Self-Help for approval. Consequently, Self-Help does not review many loss mitigation cases from Lender 5. The majority of the problems associated with Lender 5’s loans appear to be related to origination rather than servicing. However, Ms. Holder did indicate that their month end reports often contain errors regarding loan status. This suggests some problems with Lender 5’s systems.

Lender 5 began participating in the counseling program in July 2003.

<table>
<thead>
<tr>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender 5</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>4</td>
</tr>
</tbody>
</table>

**Lender 6**
Lender 6 is a flow lender. Thus, most loans have been subject to limited indemnity (see above) from the time that Self-Help has owned the loans. The limited indemnity coverage is just starting to expire. Despite this, Self-Help does not receive the number of loss mitigation cases that it would expect. To date, Lender 6 has only had one loss mitigation case. To make matters worse, they did not know that it was a Self-Help loan and thus it was not sent to Self-Help for approval. Self-Help is planning on working with them to make sure that all loss mitigation cases are sent for review.

<table>
<thead>
<tr>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
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<tbody>
<tr>
<td>Lender 6</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

**Lender 7**
Lender 7 has two forms of limited indemnity. The first is the standard 9-12 months of clean payment history that all lenders are subject to. The second is unique to Lender 7’s portfolio. Lender 7 originates loans up to 103% LTV. Any loan that defaults with an LTV over 100% must be repurchased. Consequently, Self-Help has not had many loss mitigation cases from Lender 7. Self-Help initially found it difficult to get information from them. However, things have improved. Lender 7’s loss mitigation staff is very good at strategizing with borrowers on next step solutions. In addition, they are very thorough before presenting cases to Self-Help.

<table>
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<tr>
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<th>Identification</th>
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<tbody>
<tr>
<td>Lender 7</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

**Lender 8**
Self-Help has no problems with Lender 8. They are responsive and follow Self-Help’s guidelines perfectly. The loss mitigation staff works extremely hard to help
borrowers avoid foreclosure and attempt loss mitigation alternatives before foreclosure fees whenever possible.

<table>
<thead>
<tr>
<th></th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
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<tbody>
<tr>
<td>Lender 8</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

**Summary**
The variance in total score supports the fact that some of Self-Help’s lenders are more adept at default management than others. These rankings find Lender 2, 3A, 7 and 8 to be superior servicers and Lender 3C, 4 and 6 to be inferior. However, the information used to create these rankings was limited. Thus, conducting full-scale interviews with the lenders was the logical next step.

<table>
<thead>
<tr>
<th></th>
<th>Personnel</th>
<th>Identification</th>
<th>Policy</th>
<th>Systems</th>
<th>Loss Mit</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender 1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Lender 2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Lender 3A</td>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Lender 3B</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Lender 3C</td>
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<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Lender 4</td>
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<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
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<tr>
<td>Lender 5</td>
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<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Lender 6</td>
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<td>0</td>
<td>1</td>
<td>0</td>
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</tr>
<tr>
<td>Lender 7</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Lender 8</td>
<td>1</td>
<td>1</td>
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<td>1</td>
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</tr>
</tbody>
</table>

**Servicer Case Studies**

Based on my review of existing research and discussions with Mary Holder at Self-Help, I identified four primary elements of successful servicing: personnel, systems, adherence to guidelines and counseling. Each element has a number of sub-components.

**Personnel:** The effectiveness of the servicing staff. The following influence the effectiveness of the staff:

- **Ratio of loans to employees:** Effective servicers are well staffed. Clearly, the lower the ratio of loans to employees, the more attention a troubled loan can receive. The ratio of the collections staff is important in determining the likelihood of early intervention. In addition, the ratio of the loss mitigation staff is critical in determining the level of attention devoted to curing the delinquency.
- **Experience:** As with any profession, the experience of the staff is important. Experienced employees are more likely to communicate well with borrowers and recognize the best loss mitigation strategies for any given situation.
- **Specialization:** Employees that specialize in affordable home loans are more likely to understand the challenges and needs of low- and moderate-income
borrowers. Similarly, employees that focus on certain investors are more likely to be familiar with the investor guidelines and their product types.

- Incentives: Certain servicers provide financial incentives to loss mitigation employees for the number of approved workouts. An incentive plan is likely to motivate employees to pursue workout strategies for delinquent borrowers.

**Systems:** Fannie Mae and Freddie Mac’s experiences suggest that advances in servicing technologies in the past decade have led to dramatic improvements in default management. Servicers that utilize risk scoring and workout systems are likely to be more efficient with their resources and consequently more effective in curing defaults.

**Guidelines:** Self-Help has carefully constructed servicing guidelines that are tailored to Self-Help borrowers and designed to support Self-Help’s goal of keeping borrowers in their homes. Self-Help’s impressive cure rates suggest that their guidelines and policies are effective. Thus, servicers that follow these guidelines should be more successful with default management for Self-Help loans. In order to accomplish this, servicers must be willing to customize their guidelines to specific investor requirements. Furthermore, servicing systems must clearly indicate that a loan belongs to Self-Help. Finally, employees must be familiar with Self-Help guidelines and must adhere to them.

**Counseling:** Research suggests that counseling can be very effective in reducing delinquency and preventing foreclosure. Pre-purchase counseling provides borrowers with education that can help them better manage their finances. In addition, borrowers gain knowledge about options available to them in the event of delinquency. Freddie Mac (2001) found individual programs, classroom study, and home study to be the most effective. Furthermore, delinquency counseling can provide a less threatening point of contact for borrowers, help them rearrange their finances in order to make funds available for loan payments and/or encourage them to pursue workout strategies with their servicer.

In order to better understand each of the servicers’ strengths and weaknesses, I developed a survey that addressed these servicing strategies. Based on the information that I gathered, I scored each servicer on the four above-mentioned components. Scores range from one (very poor) to five (excellent). Thus, twenty represents a perfect score.

**Lender 1**
Self-Help began purchasing loans from Lender 1 in 1997. Today, Lender 1 services 1521 Self-Help loans and approximately 45,000 loans in total.

**Personnel:** Lender 1 is understaffed. There are three collection counselors and one loss mitigation specialist managing the 45,000 loans. This generates a collection ratio of

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17 Freddie Mac (2001), Mortgage Foreclosure Prevention Program (1998), GMAC. See literature review.
15,000 loans per employee and a loss mitigation ratio of 45,000 loans per employee. There is no differentiation between conventional and affordable loans. Thus, employees are not specialized in terms of loan product. Furthermore, they are not specialized by investor. Finally, there has been high turnover with the one loss mitigation specialist position. Since 2002, four different employees have held the position. Employees are not incented with financial rewards for workouts. Score = 1.

**Systems:** Lender 1 uses Fidelity (formerly known as Alltel) as their base system. They currently do not use a risk scoring system, which suggests that this servicer is less efficient with resources, which is unfortunate given their limited human resources. Lender 1 does use a workout system, specifically the Fannie Mae Home Savers Solutions Network. Score = 3.

**Guidelines:** Collection and loss mitigation staff can easily identify Self-Help loans, as the investor number is visible in Lender 1’s servicing system. While most of their loans are serviced with the same guidelines, Lender 1 is willing to service loans according to investor guidelines. Employees become familiar with Self-Help’s guidelines via the servicing manual and by working with other employees and the team leader. Their guidelines for Self-Help loans are as follows:
- Days delinquent for first phone call: Between 7 and 10 days
- Days delinquent for first letter: 20 days
- Days delinquent for breach letter: 61 days
- Days delinquent for foreclosure referral: 91 days


**Counseling:**
The loan product that Lender 1 sells to Self-Help requires that borrowers meet the counseling requirements of Fannie Mae’s Community Home Buyer Program, which dictates that in most cases face-to-face homebuyer education is required.

Lender 1 has been participating in Self-Help’s delinquency counseling program since November 2000. Their loans were transferred to CCCS in San Francisco in July 2003. Score = 5.

**Summary**

<table>
<thead>
<tr>
<th></th>
<th>Personnel</th>
<th>Systems</th>
<th>Guidelines</th>
<th>Counseling</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender 1</td>
<td>1</td>
<td></td>
<td>3</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

**Lender 2**
Self-Help has been purchasing loans from Lender 2 since 1997. Lender 2 is a regional servicer that manages 323,272 loans in total, including 2098 Self-Help loans.
**Personnel:** Lender 2 has about thirty collection employees and four loss mitigation specialists. The collections staff manages the entire portfolio of 323,272 loans. Thus, the ratio is 10,775 loans per employee. Individual collection counselors do not specialize in affordable loans or by investor. In contrast, the loss mitigation employees each handle different investors, which allows for some specialization. There is one loss mitigation employee that handles Self-Help loans in addition to Fannie Mae and other private investor loans. My assumption is that each loss mitigation employee manages an equal amount of loans, which results in a ratio of 80,818 loans per employee. This suggests that delinquent loans receive a limited amount of loss mitigation attention. Employees do not receive financial incentive for workouts.

Score = 3

**Systems:** Lender 2 uses Fidelity (formerly Alltel) as its base system. In addition, they use risk-scoring systems, both Fannie Mae’s Risk Profiler and Freddie Mac’s Early Indicator. Finally, Lender 2 uses a workout system, specifically Fannie Mae’s Home Saver Solutions Network. However, many Self-Help workouts are designed over the phone with Self-Help.

Score = 5

**Guidelines:** Lender 2 tailors their servicing guidelines to investor requirements. In order to implement this, all system screens have investor names and codes. Furthermore, the loss mitigation staff is familiar with Self-Help’s guidelines and policies having reviewed the materials sent by Self-Help and worked closely with Ms. Holder. Their servicing guidelines for Self-Help loans are as follows:

- Days delinquent for first phone call: 17 days
- Days delinquent for first letter: 32 to 35 days
- Days delinquent for breach letter: 65 days
- Days delinquent for foreclosure referral: 95 days

Self-Help specifies that a delinquent borrower should receive a phone call by the 10th day of delinquency and a letter by the 20th day of delinquency. Thus, Lender 2 is waiting longer to contact delinquent borrowers than Self-Help would like. However, their guidelines do match Self-Help’s regarding the breach letter and foreclosure referral.

Score = 4

**Counseling:** Pre-purchase counseling is required for Lender 2’s borrowers. Each borrower must complete a homeownership counseling course offered by a community college, a private mortgage insurance company, a credit counseling service or bank personnel. Self study supervised by bank personnel is also acceptable. In addition, Lender 2 has participated in Self-Help’s delinquency counseling program since August 2002. Borrowers are referred to the credit counseling agency at the 30th day of delinquency.

Score = 5
Summary

<table>
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<tr>
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<th>Counseling</th>
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<td>3</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>17</td>
</tr>
</tbody>
</table>

**Lender 3A**

This servicer manages approximately 187,000 loans including 779 Self-Help loans. These loans were purchased from Lender 3 and the servicing was subcontracted to this servicer that specializes in subservicing prime and Alt-A mortgage portfolios.

**Personnel:** Lender 3A is well staffed. They have fifteen collection counselors and eight loss mitigation specialists servicing their 187,000 loans. They do not differentiate between conventional and affordable loans and Self-Help loans are not managed by a subset of the staff. Thus, the collections ratio is approximately 12,500 loans per employee and the loss mitigation ratio is just over 23,000 loans per employee. While Self-Help loans are “noted as high risk loans and treated as such,” their structure does not allow for employee specialization. Employees are rewarded financially for completed workouts, $25 per workout.

Score = 4

**Systems:** Lender 3A uses Alltel as their base system. (Alltel was purchased by Fidelity in 2003.) They use Risk Profiler (Fannie Mae) and Early Indicator (Freddie Mac) for risk scoring. In addition, they have been using Fannie Mae’s Home Savers Solutions Network as their work out system for the past seven years.

Score = 5

**Guidelines:** Lender 3A tailors their guidelines to meet investor needs. This is possible as each loan is identified with a class code that reflects the specific investor. However, it does not appear that employees are trained specifically with Self-Help guidelines. When asked how the employees become familiar with Self-Help guidelines, Lender 3A indicated that their policies and procedures are similar to Expanded Approval / Timely Payment Reward loans. This suggests that employees are not familiar with Self-Help’s servicing handbook. Lender 3A services Self-Help according to the following guidelines:

- Days delinquent for first phone call: 5 days
- Days delinquent for first letter: 15 days
- Days delinquent for breach letter: 65 days
- Days delinquent for foreclosure referral: 95 days

Lender 3A meets Self-Help’s guidelines. Most important, the breach letter is not sent before the 61st day. Furthermore, the first phone call and letter exceed expectations, as they are managed before the 10th and 20th day.

Score = 4

**Counseling:** Lender 3 requires that all first time home buyers associated with their affordable mortgage product receive homebuyer education prior to purchase. They define a number of acceptable sources: mortgage insurance companies (United
Guarantee, RMIC or MGIC), authorized Bank associates, community colleges, and recognized county or city home ownership credit counseling agencies.
Lender 3 refers delinquent borrowers to a HUD approved counseling agency at the 45th day of delinquency. It is the borrowers responsibility to contact the agency.
Score = 3

**Summary**

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**Lender 3B**
Declined to participate.

**Lender 3C**
Declined to participate.

**Lender 4**
Declined to participate.

**Lender 5**
Lender 5 is a national servicer that manages 434,202 loans. Self-Help began purchasing loans from Lender 5 at the end of 2000. They currently service 543 Self-Help loans.

*Personnel:* Lender 5 is well staffed. Lender 5 employs ninety collections counselors, full time and part time, and twenty full time loss mitigation specialists. Thus, their collections ratio is somewhere in the range of 5,000 to 10,000 loans per employee. Collection counselors are not specialized by loan type or investor. Lender 5 has each loss mitigation employee managing approximately 22,000 loans. They have two processors that manage the Self-Help loans in addition to some other investors, which allows for some specialization with individual investor guidelines. Employees are not rewarded financially for completed workouts.
Score = 4

*Systems:* Lender 5 uses Fidelity for their base system. In addition, they utilize a risk scoring system, Fannie Mae’s Risk Profiler. They do not use a workout system.
Score = 4

*Guidelines:* Lender 5 services all loans according to investor guidelines. It follows that Self-Help loans can be easily identified in Lender 5’s system with an investor number. In addition, Self-Help guidelines are made available to the staff. Furthermore, the staff consults with Self-Help in order to have workouts approved. Lender 5 services loans according to the following guidelines:
  * Days delinquent for first phone call: 10 days if investor requires
  * Days delinquent for first letter: 10 days if investor requires
  * Days delinquent for breach letter: 33 days
  * Days delinquent for foreclosure referral: 75 days
Lender 5 meets Self-Help’s guidelines for the first phone call and letter. However, the breach letter is sent out on the 33rd day, which is significantly earlier than Self-Help specifies. In addition, Lender 5 refers a loan to foreclosure at the 75th day of delinquency rather than the 91st day of delinquency. However, it is important to note that Lender 5 does usually wait until the 90th day of delinquency to refer a loan to the foreclosure attorney, although it varies according to state requirements.
Score: 3

Counseling: The loan product that Self-Help buys from Lender 5 requires pre-purchase counseling for all borrowers. The counseling agency must meet Fannie Mae, Freddie Mac and FHA requirements. HUD certified programs are recommended although others are accepted. If face-to-face counseling is not available, then tele-counseling is acceptable. In addition, Lender 5 has participated in Self-Help’s delinquency counseling program since July 2003.
Score = 5

Summary

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</table>

Lender 6
Declined to participate.

Lender 7
Lender 7 services approximately 55,000 loans from all over the country. They are currently servicing 1916 Self-Help loans. The loan product differs from the majority of loans in Self-Help’s portfolio in that LTVs are as high as 103%.

Personnel: Lender 7 is extremely well staffed. Eight employees in collections (including managers) and three loss mitigation specialists manage the 55,000 loans. On the collections side, different employees handle affordable loans and conventional loans. A single collection counselor handles the 1,982 affordable loans that Lender 7 services. Thus, the collection counselor that handles Self-Help loans clearly has specialized knowledge regarding servicing of affordable home loans. Furthermore, this employee has been with Lender 7 for ten years. In contrast, the loss mitigation department does not differentiate between conventional and affordable loans. Thus, the three loss mitigation employees manage all 55,000 loans, resulting in a loss mitigation ratio of 18,333 loans per specialist. Although they are not specialized by loan product or investor, the specialists are all extremely experienced, as each has been with Lender 7 for over ten years. Lender 7’s employees do not receive financial incentives for workouts.
Score = 5

Systems: Lender 7 uses FiServ as their base system. They began using Fannie Mae’s risk scoring system, Risk Profiler, when it became available. In addition, Lender 7 utilizes
Fannie Mae’s Workout Profiler, for structuring delinquency workouts. The loss mitigation staff feels Workout Profiler is better than other workout systems as it is more user friendly.
Score = 5

Guidelines: Lender 7 tailors their servicing guidelines to meet investor requirements. Self-Help loans are identified in their system with an investor number that is visible to people working in collections, loss mitigation and foreclosure. Their guidelines for Self-Help loans are as follows:

- Days delinquent for first phone call: 17 days
- Days delinquent for first letter: 20 days
- Days delinquent for breach letter: 90 days
- Days delinquent for foreclosure department referral: 120 days

Lender 7 calls a delinquent borrower seven days after the Self-Help guideline specifies. In addition, the breach letter and foreclosure referral timeframes are slightly more generous than those specified in Self-Help’s servicing manual. Furthermore, in certain situations, the loss mitigation staff will extend the time before foreclosure referral if the loan is likely to cure in the immediate future. For example, if borrowers are waiting on approval for Social Security Disability and they can provide sufficient documentation that funds will be received in the near future, they can receive some additional time to cure their delinquency. Despite the discrepancy in the guidelines, Ms. Holder has stressed repeatedly that she is more concerned with loans receiving breach letters and foreclosure referrals too early rather than later and she encourages the servicers to be flexible in cases when an extension is likely to resolve a delinquency.
Score = 4

Counseling: Lender 7’s pre-purchase counseling is limited. Borrowers receiving zero down payment loans are required to read and sign a document as part of the closing process. Foreclosure prevention counseling consists of referring borrowers to Consumer Credit Counseling Services. This is done on a case-by-case basis. It is up to the borrower to contact the counseling service in order to receive assistance.
Score = 2

Summary

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Lender 8
Self-Help began purchasing loans from Lender 8 in 1994. Lender 8 has outsourced the servicing for some of the loans sold to Self-Help. However, they maintained the servicing of the loans purchased in 2001. Lender 8 services approximately 102,000 loans, from all over the county. Their portfolio includes 343 Self-Help loans.
**Personnel:** Lender 8 has twenty-five collection counselors and one loss mitigation specialist managing the 102,000 loans. There are two specific collection counselors that handle the Self-Help loans in addition to other specific investors. This suggests a certain level of specialization with investor guidelines. I was not able to get the number of loans that they manage and thus will assume that the loans are evenly distributed among the collection counselors, which results in a ratio of 4,080 loans per employee. Thus, the collections ratio is very strong. However, there is only one loss mitigation employee that handles the 102,000 loans, which results in a very poor loan to employee ratio and a lack of specialization. Employees do not receive financial rewards for loan workouts. Score = 3

**Systems:** Lender 8 uses Fidelity as their base system. In addition, they use Freddie Mac’s Early Indicator for risk scoring. However, they do not use a workout system. Score = 4

**Guidelines:** Specific coding and loan numbers can identify the investor for any particular loan. In addition, Lender 8 provides in house training with materials sent to Wachovia by Self-Help. However, Lender 8’s system is coded to send breach letters and refer loans to foreclosure based on a single set of guidelines. They are not customized to meet investor requirements. All loans are serviced with the following guidelines:

- Days delinquent for first phone call: 5 days
- Days delinquent for first letter: 10 days
- Days delinquent for breach letter: 35 days
- Days delinquent for foreclosure department referral: 65 days

These guidelines clearly do not match those provided by Self-Help. Self-Help specifies that breach letters should not be sent before the 61st day of delinquency and foreclosure should not occur before the 91st day of delinquency. By sending the breach letter and starting foreclosure so early, Lender 8 is seriously limiting the time for a borrower to cure his or her delinquency. This clearly conflicts with Self-Help’s mission of keeping borrowers in their homes. Score = 2

**Counseling:** Self-Help purchases three different loan products from Lender 8. The zero down payment product requires borrowers to participate in a homeownership and personal finance education program by a recognized community organization or in an educational session arranged by the lender. One of the 97% LTV products requires homebuyer education. The other requires homebuyer education unless the borrower meets all of the following conditions:

- Has previously owned a home
- Makes at least a 5% cash down payment from their own funds
- Has cash reserves after closing that are at least equal to two monthly mortgage payments.
In addition, Servicer 8 has participated in Self-Help’s delinquency counseling program since September 2003.
Score = 5

| Summary |
|---------|---------|---------|---------|---------|
|         | Personnel | Systems | Guidelines | Counseling |
| Lender 8 | 3        | 4       | 2         | 5         |
|          | 14       |

**Conclusion**

My literature review and conversations with Self-Help and various servicers all suggest that there are specific strategies that increase the probability of curing a defaulted loan. As the industry seeks to increase homeownership by offering more affordable loan products, it is imperative to understand the impact of each of these strategies.

The importance of early intervention came up again and again. There are a variety of measures that servicers can take to improve their effectiveness with early intervention. Pre-purchase counseling helps borrowers understand the servicing process so that in the event of a delinquency, borrowers will engage with the servicer early on to resolve the situation. Clearly, a well-staffed collections department is also critical. In addition, risk-scoring systems can greatly improve a servicer’s efficiency as it directs resources to borrowers that need the intervention. Finally, aggressive guidelines regarding initial phone calls and letters can only help servicers reach borrowers before they get into serious trouble.

However, low-and moderate-income borrowers have less reserve to fall back on in the case of an unexpected expense or reduction in income. This increases the chances that a delinquency will extend beyond an “early” stage. Thus, it is critical that servicers be prepared to handle more serious delinquencies as well. Again, a strong loss mitigation staff is critical. In addition, a workout system can help loss mitigation associates design workouts that are optimal for the borrower. Delinquency counseling is another important component of default management. A counseling agency can be a less threatening point of contact for an anxious borrower. Furthermore, a counselor can help a borrower rearrange his or her finances in a way that makes funds available for loan payments. Finally, it is critical that servicers have guidelines that allow enough time for a borrower to cure a delinquency before referring the loan to foreclosure. This includes allowing for some flexibility in the referral process if a borrower can provide evidence that he or she will be able to cure the delinquency in the near future.

The previous research indicates that some of Self-Help’s servicers are more effective at default management than others. Thus, it comes as no surprise that the case studies reveal wide variations among the servicers on four elements of successful servicing: personnel, systems, adherence to Self-Help guidelines and counseling. Summary scores
also vary, but to a lesser degree. Thus, servicers that are weak in some areas generally make up for it in others. However, the rankings do suggest that based on their servicing operations and strategies, Lender 2 should outperform the other servicers. In contrast, Lender 1 and Lender 8 should be the least effective.

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The fact that there are clear differences revealed in the delinquency spell model and subtle differences in the total scores presented here suggests that some of the components may have more impact than others. Adding these new variables to the delinquency model should lead to some conclusive evidence regarding the impact of each of these components on the effective servicing of affordable home loans.

My hope is that this information will lead to improvement in the servicing arena, which will in turn reduce investor risk associated with affordable mortgage products and help more low- and moderate income borrowers build wealth through homeownership.
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