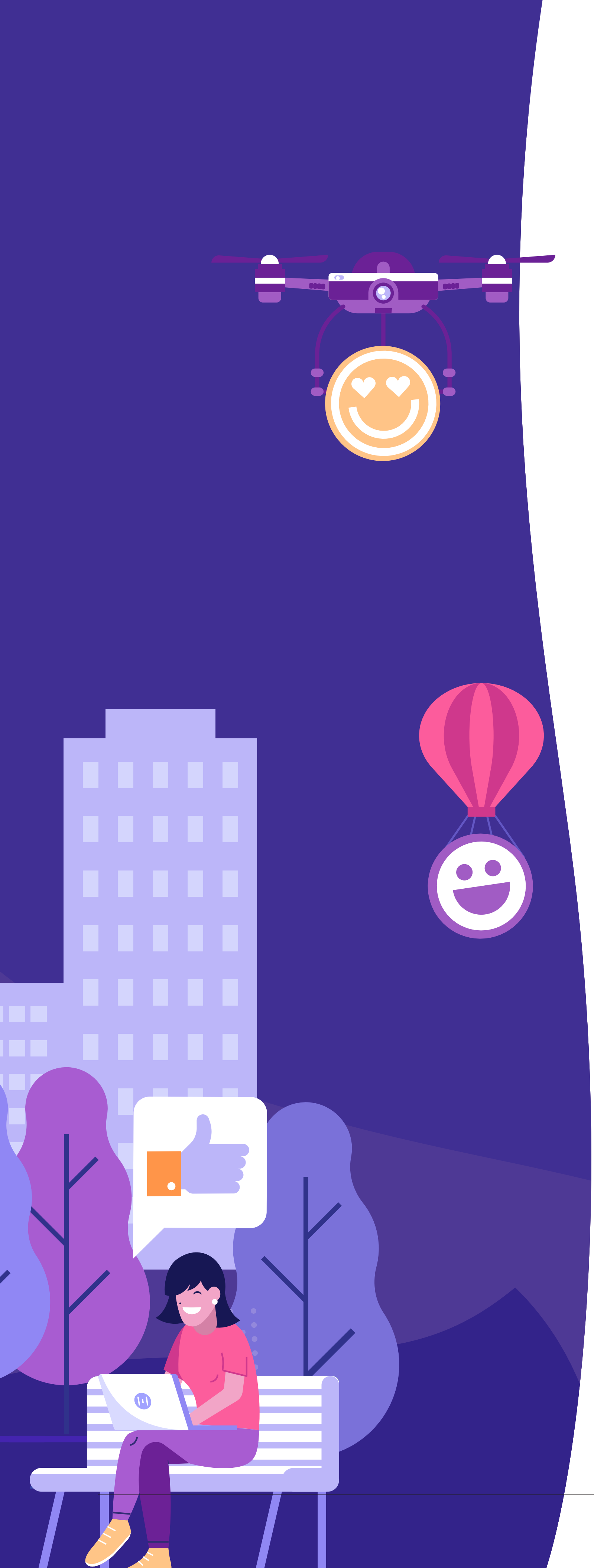
A DECADE LATER

WHAT A DIFFERENCE 10 YEARS MAKE



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Backstory

Default servicing changed dramatically since the mortgage meltdown crisis which began approximately in 2008. The surge in delinquencies led to increased regulatory oversight, and increased staffing and use of technology to comply with increased regulations and with increased borrower interaction. The chart below illustrates this surge.

For default servicing participants, servicers, law firms, vendors, borrowers, borrowers' law firms and consumer groups, there is a new normal work environment involving audits, questionnaires, policies and procedures, standard operating procedures (SOPs), training and so on.

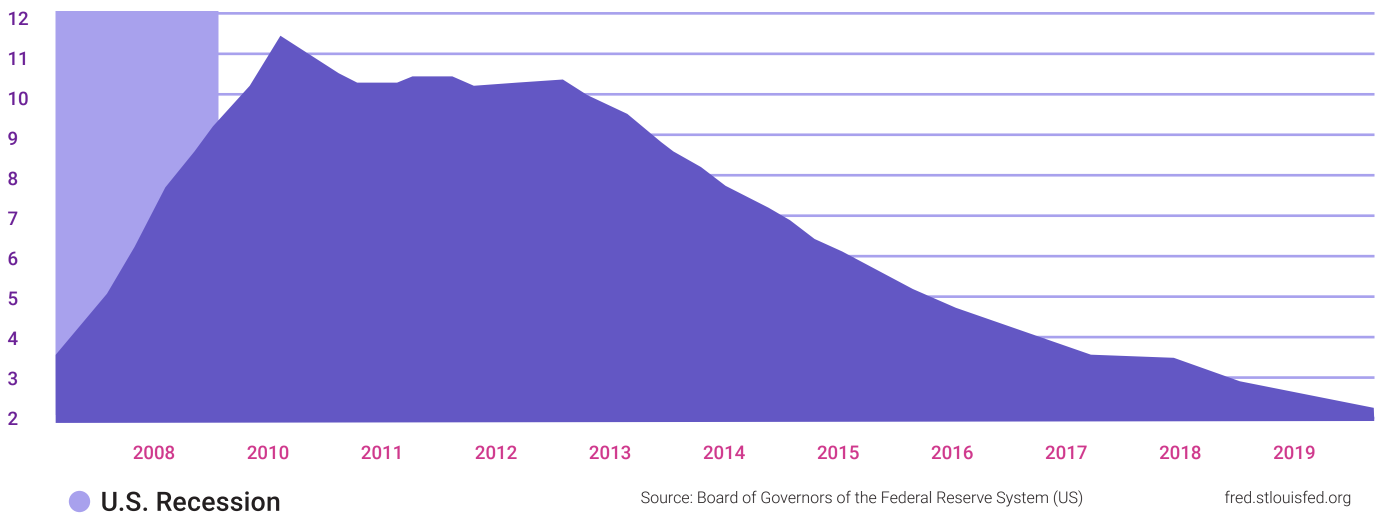
Servicing fees (annual fixed fee of 19 to 69 basis points, or .19 to .69 percent) compensate mortgage servicers for managing loans from post-closing until loans are terminated, by maturity of the loan, the most common, foreclosure, or a foreclosure alternative, such as a deed-in-lieu or short sale. Servicing fees are paid as part of borrowers' monthly payment, and the remainder of the payment is paid to the investor who owns the loan.

Despite the financial crisis ten years ago, default rates are at a twenty-year low. According to CoreLogic, the serious delinquency rates (90 days or more past due or in foreclosure) for Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), and conventional loans were 3.3%, 1.8%, and 0.9%, respectively.[1]

Pre-crisis servicing increased servicer responsibility from simply collecting and processing payments and escrows to these duties plus handling distressed borrowers and a flood of loss mitigation

[1]https://www.corelogic.com/blog/2020/1/mortgage-delinquency-rates-for-all-loan-types-have-fallen-to-their-lowest-in-20-years.aspx

Delinquency Rate on Single-Family Residential Mortgages, Booked in Domestic Offices, All Commercial Banks



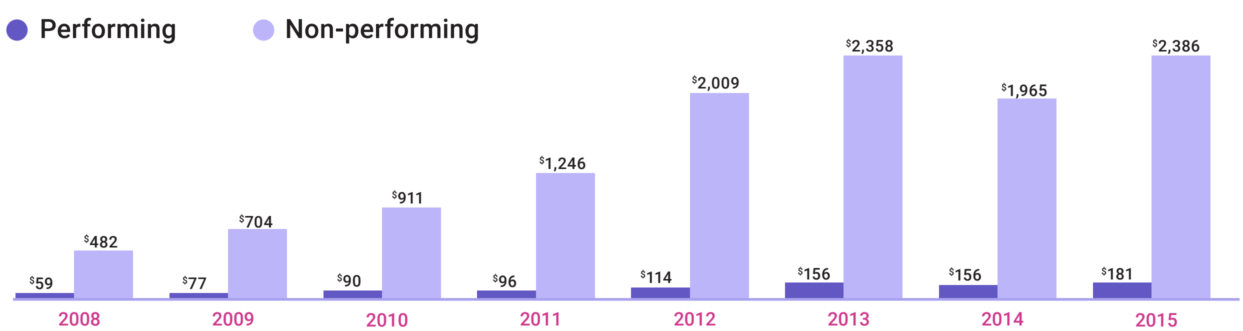
Source: Board of Governors of the Federal Reserve System (US) fred.stlouisfed.org

requests and implementation of regulatory requirements during and after the crisis. Fannie Mae, Freddie Mac, Federal Housing Administration, Department of Veterans Affairs, the Consumer Financial Protection Bureau, and the U.S. Department of the Treasury all developed new loss mitigation programs, revamped servicing policies, and created new regulations for the servicing industry.

what documentation to request from the borrower, and what loss mitigation options to offer in what order. As a result, servicing responsibilities and costs have greatly increased.

Business model changes are proposed, both to address increased servicing costs, as well to improve the consumer experience, a component receiving attention in a boom economy.

Servicing costs per loan have increased dramatically



Source: Mortgage Bankers Association
Note: Non-performing loans = loans where borrowers are at least 30 days delinquent

For example, new requirements covered every step of the loss mitigation process, such as how often and when servicers can contact a struggling borrower,

Customer Experience

Certainly the business model for default servicing compensation for servicers needs to be updated, and

[2]https://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-servicing-collaborative
[3]Mortgage Bankers Association

industry participants are working on identifying the issues and proposing solutions. For example, the Mortgage Servicing Collaborative (MSC), a group of industry participants, servicers, academic and consumer groups, founded in 2017 under the Urban Institute umbrella, which was founded in 1968, focuses on issues such as: servicing FHA loans, government loan modifications, cost to service nonperforming loans, misalignment of servicing standards, access to credit, servicing compensation, and role of technology. [2]

Per the MSC, the data is:

Lending trends.

Drop in lending to vulnerable populations. Between 2006 and 2015, loans to low- and moderate-income borrowers decreased 35 percent; loans to African American and Hispanic borrowers decreased 64 percent.

Skyrocketing costs.

The cost to service a performing loan tripled between 2008 and 2015 (from $59 to $181); the cost to service a nonperforming loan increased fivefold (from $484 to $2,386). Servicer compensation did not change during this same period.[3]

Domination of nonbank servicers.

From 2013 to 2016, the share of nonbanks servicing FHA loans increased from 35 percent to more than 70 percent. The share of nonbanks servicing GSE loans increased from 30 percent to 50 percent.

Moving from the industry side of transformation over the past decade, borrowers increasingly use technology, namely websites and mobile applications to shop for loans and to complete transactions. About one in four borrowers use the same servicer to originate or refinance a mortgage as of the end of 2019, contrasted with three out of four in late 2017.[4] Servicers know the customer experience is important, because of competition from other servicers and the opportunity to cross sell.

J.D. Power surveyed consumers about satisfaction with their mortgage servicers, with Quicken Loans ranked at the top for the sixth consecutive year with a score of 878 out of 1,000 for 2019. The study measured five factors: communications, customer interaction, billing and payment process, escrow account administration, and new customer orientation, and used responses from 7,531 customers who originated or refinance more than twelve months ago. Anecdotally, Quicken calls their borrowers "clients," and bend over backwards to work out defaults.[5]

"Mortgage servicers are really missing an opportunity to build the kind of goodwill with their customers that has proven to translate directly to increased advocacy and repeat business," said John Cabell, Director of Wealth and Lending Intelligence at J.D. Power. "The industry's laser focus on lowering costs, managing regulatory compliance and minimizing delinquencies has come at the expense of customer experience. It is negatively affecting customer trust in their brands."[6]

Could these findings provide guidance for all industry participants? What once was a less complex business model, servicing mostly performing loans and some nonperforming loans, has become more regulated by government and accountable to consumers. The continued use of technology to reduce costs and increase profitability should be used to improve customer experience, much like Quicken has done with its fully digital closing process. Again, anecdotally, the digital experience led one young couple to select Quicken over other lenders/servicers. What can the industry learn from these results, more than ten years after the crash? Exciting times await us all.

Postscript—This article was written prior to declaration of a National Declaration of Emergency on March 15, 2020 due to the coronavirus. Though we don't know exactly how this will all turn out, use of technology throughout our industry will continue to increase, a side benefit of which is better social distancing!

[4]https://cdn.blackknightinc.com/wp-content/uploads/2019/12/BKI_MM_Oct2019_Report.pdf
[5]https://www.jdpower.com/business/press-releases/2019-us-primary-mortgage-servicer-satisfaction-study
[6]Id.