



DLS

**servicing
consultants, llc.**

**Outsourcing Loss Mitigation
Focus - Disasters
March 2019**

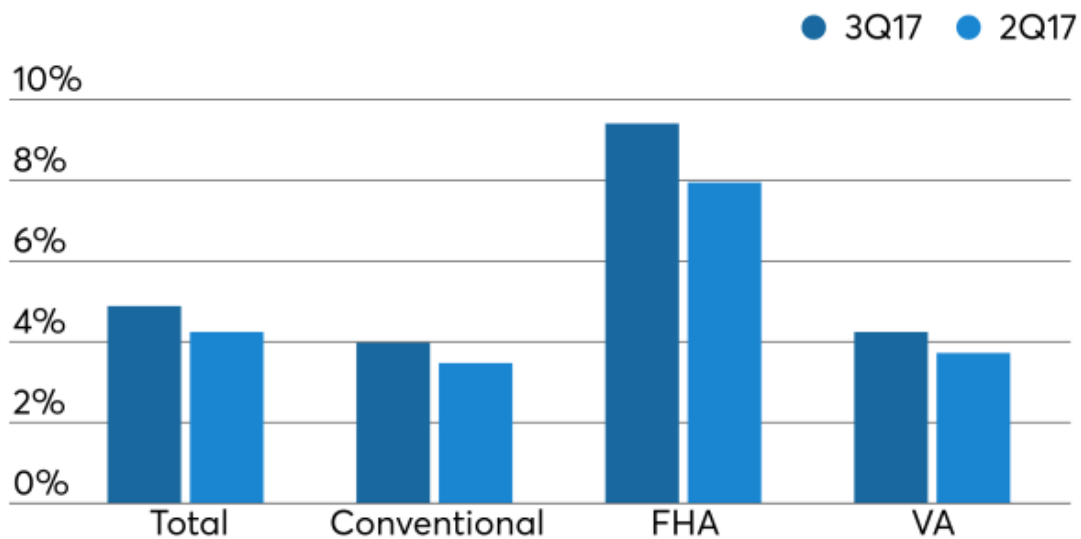
Analysis

I. Introduction

The disasters that befell the Atlantic coastal regions over the last several years have left mortgage servicing operations searching for cost effective and efficient answers to resolve a multitude of delinquencies. Some delinquencies were a direct result of the disaster on properties or borrower income. Other delinquencies were a result of other factors but were compounded by the disaster aftermath. Many Servicing organizations were themselves a victim of the disaster, whether it was building damage or working with employees that were adversely affected.

Storm surge

Borrowers affected by the three hurricanes that didn't make their monthly payment drove the quarter's rise in delinquencies



Source: Mortgage Bankers Association

As published by **National Mortgage News**, [Mortgage Delinquencies Rise Following the three Hurricanes](https://www.nationalmortgagenews.com/news/mortgage-delinquencies-rise-following-the-three-hurricanes?tag=00000154-3936-d507-a9dd-bdfe87280000) (November 17, 2017 - <https://www.nationalmortgagenews.com/news/mortgage-delinquencies-rise-following-the-three-hurricanes?tag=00000154-3936-d507-a9dd-bdfe87280000>)

The devastation has had long lasting effects. According to **USA Today** article, [Hurricane Maria's economic impact on Puerto Rico](https://www.usatoday.com/story/news/2018/12/04/hurricane-maria-economic-impact-puerto-rico/2209231002/) (December 6, 2018 - <https://www.usatoday.com/story/news/2018/12/04/hurricane-maria-economic-impact-puerto-rico/2209231002/>) "The latest report from Puerto Rico's planning board paints a grim picture, estimating the impact of Hurricane Maria on the island's economy at \$43 billion, \$1 billion more than

the original assessment. . . . “A lot remains to be done,” said island-based economist Jose Caraballo, adding that federal aid and insurance payments have covered just 24 percent of the losses. “The economic impact of the reconstruction has not been felt.””

Exasperating the recovery efforts is a mass exodus of Puerto Rican citizens from the island to mainland United States. “New data from the Puerto Rico Institute of Statistics shows that a net total of 150,000 people left the island in fiscal year 2018. That’s about twice the average migration from the previous two years, when roughly 90,000 Puerto Ricans left, mostly to escape Puerto Rico’s economic crisis.” Quoted from **Vox** – Hurricane Maria: 4 ways the storm changed Puerto Rico – and the rest of America (9/20/2018 - <https://www.vox.com/2018/9/20/17871330/hurricane-maria-puerto-rico-damage-death-toll-trump>)

Mortgage Servicers are faced with unprecedented volume of delinquencies, lack of experienced staff trained to identify the best loss mitigation approach for each circumstance, an inability to locate borrower/homeowners and obtain the documentation necessary to qualify for assistance and a struggling economy that may require assistance above the standard disaster response, now and for the foreseeable future.

The use of an outsourcing team of professional inspectors and loss mitigation underwriters is the most efficient, effect approach to resolving the delinquent mortgage burden currently carried by Puerto Rico’s largest mortgage servicers.

II. Loss Mitigation 101

Loss Mitigation is a term to explain a group of programs offered by insurers and Note Holders designed to reduce their losses on eventual foreclosures, by offering assistance to delinquent borrowers. The ultimate goal is to save the insurer from paying full claims on foreclosed properties or to save the Note Holder from losses on foreclosures especially when property values declined since origination or when the loan is so new, that the borrower has not built enough equity for the Note Holder to recapture their investment in the mortgage by selling the property after foreclosure and foreclosure related expenses.

Loss Mitigation gained popularity in the early 1990s, when years of relaxing underwriting standards, resulting in higher front end debt ratios (the total mortgage payment of principal, interest and escrows divided by borrower’s gross monthly income) meant that the standard default resolution option of a repayment plan was proving to be less and less effective. It was typical in the 1980s that no more than 28% of a borrower’s income was used to qualify for a first mortgage. Over time, that number has increased to 40% or more. When the borrower is left with less disposable income they just do not have the resources necessary to make up missed mortgage payments through a repayment plan. Therefore, for those borrowers who could prove that they could at least afford the monthly payment, insurers and Note Holders began to offer other means to catch up the past due amounts – the modification and subordinate mortgage programs were born.

A modification is capitalizing (adding amounts to the current unpaid principal balance) of delinquent interest, escrow advances or projected shortages and corporate advances made by mortgage servicers

to protect their collateral interest in the loan by instituting inspections or foreclosure actions. Some modifications extend the term, change the interest rate and re-amortize the new balance – these adjustments are governed by the insurer or note holder requirements.

Fast forward to the housing crises of 2008. Prior to this period, the typical reason for defaulting on a mortgage was excessive obligations (a borrower had a large unexpected bill that took precedence over their normal monthly expenses or they simply mismanaged their monthly budget); during the crises there was a sharp increase in unemployment and a permanent loss of income. This meant that borrowers were unable to resume making even their monthly payment, so the existing loss mitigation options needed to be altered to introduce payment reducing options – the HAMP (Home Affordable Modification Program – offered by the Treasury and FHA) and similar programs were born.

Loss Mitigation is now a more complicated calculation of what is the reason for default, how much payment assistance does the borrower actually need and can the insurer and/or Note Holder feasibly offer this assistance while still remaining profitable. The answer to the last consideration has been approached differently by each of the entities (FHA, VA, Rural Housing, Fannie Mae, Freddie Mac and a host of other private banks and equity firms).

Finally, introduce the insurer and note holder response to delinquencies that came about because of a natural disaster. All entities have special programs that assist borrowers who were current just prior to the natural disaster with low documentation forbearance plans (specified periods when either no or a very low monthly payment is made, while the borrower coordinates property restoration efforts or regains employment that may have been temporarily or permanently effected), modifications, or in the case of a limited FHA program, a subordinate mortgage that would supply funds to reinstate the delinquency.

Typically the disaster modification option offered by most entities is sufficient to bring the loan current. The typical program allows for the past due interest and any projected escrow shortage to be capitalized and the term extended either for the length of the delinquency (the loan is four months delinquent, so the term extended an additional four months) or if the loan is part of a securitization (GNMA pool), the term is extended for another 180 or 360 months. However, for some borrowers, the standard modification offering results in a higher mortgage payment, which could prove to be an insurmountable burden.

A loan secured by a GNMA pool, which would be most FHA (Federal Housing Administration), Veterans Administration, and Rural Housing Service insured/guaranteed loans, cannot be modified unless the loan is purchased out of the GNMA pool, using servicer assets and then resold into a new GNMA pool that reflects current market rates and uniform terms, such as 180 or 360 months. This means that unless a servicer has sufficient cash on hand to repurchase their delinquent loans and retain them in their own portfolio, they must modify the loans under current terms, so the loans can be resold into a new pool. In our current rising interest rate environment, this means that borrowers who were delinquent only as a result of a natural disaster, may be forced into a higher interest rate than they originated their loan with, resulting in a higher monthly payment than before the disaster. With loans

being approved with higher frontend debt to income ratios, this could put some borrowers in severe hardship; and none of it was a result of their own carelessness or disregard for their obligation. For these borrowers it is necessary to look beyond the standard disaster loss mitigation offerings and look to the options that offer payment reduction evaluations.

Given the devastating effects of hurricane Maria on not just the properties of Puerto Rico, but also on the economy – it is even more crucial that an experienced loss mitigation specialist review the circumstance for each borrower and customize the appropriate loss mitigation option response. This is to ensure that the loan remains current, long after the recovery effort.

FHA is one of the largest insurers of mortgage loans on the island of Puerto Rico. FHA insures the Note Holder against losses they experience in the unfortunate event of a foreclosure. FHA allows loans to be originated with only 3.5% borrower down payment, which means there is not sufficient equity in the collateral property to protect lenders from expenses they will incur should they exercise their right to foreclose and take possession of the property due to a borrower's default. FHA is a government agency that acts independent of the federal treasury and is supported by premium payments by the borrower of an FHA loan. These premiums are collected monthly and paid out based on claims made by mortgage servicers.

In response to mounting losses in 1996, when property values in some parts of the United States decreased dramatically and a significant number of loans were in default, FHA designed a program called the Partial Claim. This allowed a servicer to exact a portion of their foreclosure claim funds to reinstate a delinquent mortgage, in the hopes that once the loan was brought current, the borrower would be able to maintain the debt and a foreclosure could be avoided. From March 1, 2018 through February 28, 2019, FHA paid out 46,104 Partial Claims as part of their overall Loss Mitigation assistance programs (according to the FHA Neighborhood Watch Servicing Portal - <https://entp.hud.gov/sfnw/public/>). In theory, each one of these loans has avoided a foreclosure action. In return for offering the partial claim payment, FHA requires that the borrower sign a promissory note and subordinate mortgage for the amount of the claim, payable to Housing and Urban Development, at 0% interest with no payments due until the first insured mortgage is satisfied.

During the 2017 hurricane season, FHA offered a partial claim option for those loans affected by Irma, Harvey and Maria, if the modification option would result in a higher monthly payment. Then in Mortgagee Letter 2018-05 released on August 15, 2018, FHA granted special instructions for those FHA loans still affected in Puerto Rico and the US Virgin Islands. The partial claim option must be offered to all borrowers who were no more than 60 days delinquent as of the date the disaster. Currently the offer of the Partial Claim only option expires on May 1, 2019 (though this could be extended). In order to qualify for this option, the following conditions must be validated and documented:

1. The Mortgage was current or less than 60 days past due as of the date of the applicable Disaster Declaration;
2. The Mortgagee confirms that the Borrower's income (e.g., wages, social security, pension, annuity, etc.) is equal to or greater than it was prior to the Disaster;

3. The Borrower demonstrates the ability to resume total monthly mortgage payments of Principal, Interest, Taxes, and Insurance (PITI);
4. The dwelling is owner-occupied;
5. The total Principal and Interest (P&I) amount of a Borrower's monthly Mortgage Payment does not change;
6. The Mortgagee waives the Borrower's accumulated late fees; and
7. The Disaster Standalone Partial Claim is subject to the maximum statutory value of all Partial Claims for an FHA-insured Mortgage.

For most FHA loans that meet the above criteria, this would be the best option for the borrower, UNLESS they have experienced a loss of income, then a review for the payment reducing HAMP option should be considered. One more note about FHA loss mitigation – FHA delegates the loss mitigation underwriting to the mortgage servicer and requires robust documentation to support all decisions and option offerings made. If during a subsequent audit of the portfolio, FHA believes that the servicer did not act in the best interest of the insurance fund or the borrower or if they believe the servicer miscalculated the assistance in error of their guidelines, FHA will require a repayment of the partial claim and the servicer will be required to take title to the subordinate mortgage through assignment. This is why it is critically important to have individuals well versed in FHA requirements, perform the loss mitigation evaluation.

There is no window for resolving the disaster related defaults for VA, Rural Housing or other loan types with the standard disaster modifications.

III. Offering

JGM Property Group (JGM) has partnered with DLS Servicing Consultants (DLS) and Claims Recovery Financial Services (CRFS) to offer Loss Mitigation assistance designed to help local Puerto Rico mortgage servicers resolve their delinquencies through compliant loss mitigation and claim filing.

JGM offers experienced, local property inspectors who can determine that the properties have been repaired and/or help find the location of borrowers who may still be displaced to determine their intentions towards the property. JGM is a registered Puerto Rican corporation with a presence on the island.

DLS Servicing has over 25 years of consulting experience with a focus on FHA and default servicing, as well as over ten years of loss mitigation outsourcing experience. Our clients range from state housing authorities to large servicers; handling all of their loss mitigation underwriting responsibilities or only a portion, depending on expertise and portfolio make up. DLS has created an online loss mitigation application, WaterfallCalc.com, which is widely used by over 30 mortgage servicing entities. This application performs all of the calculations necessary for all home retention options offered by the major insurer and government sponsored entities. We have been found to be in compliance based on numerous insurer and state audits.

CRFS is an experienced FHA claims processor with direct EDI connection for the filing of claims to HUD. DLS Servicing has a download process of claim information that exports the data directly to CRFS which ensures prompt and accurate claim filing.

The offering is as follows:

Option 1 (FHA loans Only):

- The bank would identify all originally identified owner occupied loans that were not more than 60 days delinquent just prior to the disaster and provide a report of borrower names, property address, mailing address and other related contact information.
- JGM would use this information to make an appointment with the borrower to inspect the property, validate occupancy and gather necessary documentation.
- If the home is still owner occupied and the condition of the property shows that collateral value was maintained (all major storm related repairs were completed), the borrower would be asked to provide evidence that their income has remained unchanged from before the disaster (take pictures of before and after paystubs, bank statements showing similar deposits, etc.), also they would be asked to sign an Affidavit (provided by DLS) that states that their income is the same or better, they are able to continue making their monthly mortgage payment and that all disaster related repairs were completed. If the borrower cannot produce the necessary documentation – the inspector will leave an information packet that will explain how the borrower can upload the information to DLS.
- If the home is still in disrepair or not owner occupied – this information will be conveyed to the Bank. The bank can determine if they would like JGM to make further attempts in locating the borrower and determine the future status of the property.
- For borrowers who are not making the same or more income, then we would convert them to Option 2.
- Once the appropriate information is obtained from the borrower – it is uploaded to DLS Servicing's portal. The bank will either provide remote access to their servicing system or provide screen prints of pertinent data fields (UPB, Last paid installment, escrow information, etc), so that we may prepare a detailed escrow analysis and appropriate calculations for the partial claim.
- Once properly calculated, DLS Servicing will work with their document provider to prepare the Subordinate Mortgage and Note (in both Spanish and English). The original documents will be provided to JGM to coordinate the execution of the documents by the borrower, delivering the original documents to the bank for recording. DLS could help with this aspect of the process if the bank needs the assistance (for an additional fee).
- Optionally, DLS could communicate the partial claim amount to CRFS for EDI filing of the claim.

Cost - \$100 JGM – Document Gathering & Inspection
\$150 DLS – Loss Mitigation Review
\$ 75 DLS – Partial Claim Documentation
\$100 CRFS – Electronic Claim Filing

Option 2 (All Loan Types):

- The bank would identify those borrowers who were ineligible for Option 1 and provide a list of property address, borrower names and contact information to JGM
- JGM would contact the borrower to arrange an appointment to inspect the property (ensuring damage has been repaired and owner occupancy) and to obtain the basic loss mitigation documentation – facially complete package of: 2 consecutive paystubs or one month’s income documentation, 2 months bank statements or a signed document that states the borrower does not have a bank account and 2 years of income tax documentation.
- The documentation is uploaded to DLS portal
- DLS Servicing will comply with CFPB communication timelines and underwrite the borrower’s financial condition based on the insurer’s (FHA, VA or Rural Housing) required waterfall approach, providing that the bank provide either system access or screen prints of the pertinent loan data. DLS will provide a fully documented, auditable file along with the detailed calculations and preliminary trial payment schedules. DLS will further load the information into our online Loss Mitigation application – WaterfallCalc.com.
- Client will be able to request the loan modification/subordinate mortgage documentation from the online WaterfallCalc.com system once the borrower makes the final trial payment. The system fully integrates the calculations into the appropriate documents – which would be produced in both English and Spanish.
- Since Modification documents must be notarized – JGM would not be able to assist with the execution of these documents.
- The client could optionally coordinate with CRFS should they like assistance with the filing of the loss mitigation claims with FHA or RHS (as applicable).

Cost - \$100 JGM – Inspection
\$300 DLS – Loss Mitigation Review
\$ 75 DLS – Mod/Partial Claim Documentation
\$100 CRFS – Electronic Claim Filing*

*Reflects only Partial Claim pricing, if other claims are necessary (modification, short sale or DIL – other costs would be incurred)

IV. Benefits to Mortgage Servicers

By providing experienced staff willing to pursue and obtain the appropriate documentation, as well as provide the appropriate underwriting analysis and calculations for the correct loss mitigation option, the JGM/DLS team will exact a default resolution for each servicer without the need to staff and train additional personnel, while at the same time ensuring quality compliance.

According the FHA’s Neighborhood Watch (as of February 28, 2019) the top Puerto Rican banks have the following default statistics in just the FHA portfolio are as follows:

Servicer	Active Portfolio	30 Days Delq	60 Days Delq	Seriously Delq Loans	Total Delq Loans as of 2/28/19	% Seriously Delq Loans	In Fcls Count	In Fcls Rate
FIRST BANK OF PR	9907	564	229	813	1606	8.2	364	3.67
BANCO POPULAR DE PUERTO RICO	78722	4359	1744	6948	13051	8.82	417	0.52
ORIENTAL BANK	2132	95	24	113	232	5.3	52	2.43
BANCO DE SANTANDER-PR N.A.	2107	116	37	142	295	6.73	72	3.41
SCOTIABANK DE PUERTO RICO	16201	705	259	1027	1991	6.33	418	2.58

FHA does not pay an incentive to the servicer if the loan is brought current through option 1, however, if it becomes necessary for the loan to be considered for other loss mitigation options, all loss mitigation incentives are available to the servicer. FHA pays \$500 for each partial claim filed and \$750 for each modification claim. Some loans will qualify for both the Partial claim and the modification claim (total \$1250). VA pays a claim for each modification based on the servicer's tier ranking. Further if the borrower has decided to not reoccupy the property, we could move towards a Preforeclosure Sale or Deed in Lieu option where other incentives are available. FNMA and FHLMC offer their own incentives for modification processing.

The servicer has the potential to recapture their entire expense and more through the insurer/investor incentive programs. Utilizing experienced loss mitigation underwriters provided by DLS Servicing will ensure that all loss mitigation efforts will be compliant and work to the benefit of all parties – the servicer, borrower, insurer and investor.

Working as a team, JGM, DLS and CRFS can assist the servicer in reducing overall delinquency, keeping the servicer compliant with GNMA maximum default ratio requirements. Lower default rates also decrease the strain on servicer cash flow and net worth requirements, by reducing the amount of funds needed to advance to GNMA and other MBS securities for delinquent loans.

V. Conclusion

Utilizing an outsourced, aggressive approach to loss mitigation can work to bring these numbers down without a permanent staffing investment.

This proposal is for services on the disaster impacted portfolio, but can also be converted to assist the mortgage servicer for the foreseeable future.



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