The Mortgage Servicing Collaborative

Setting the Stage for Servicing Reforms

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All mortgage market participants share the same goal: successful homeownership. Failure to achieve that goal hurts not only consumers and neighborhoods, but investors, insurers, guarantors, and servicers. Successful homeownership hinges on several factors. Consumers need access to a range of mortgage products when buying a home and need effective mortgage servicing. Servicing is the critical work that begins after the mortgage loan is closed and includes collecting and transferring mortgage payments from borrowers to investors, managing escrow, assisting borrowers who fall behind on their payments, and administering the foreclosure process. If closing the loan is the birth of the mortgage, servicing is its day-to-day care.

Despite its importance, mortgage servicing is frequently overlooked in major policy conversations, including the housing finance reform debate. That is a mistake. The servicing industry has changed dramatically since the 2008 mortgage default and foreclosure crisis and subsequent Great Recession. Overlooking servicing while implementing changes to the housing finance system has resulted in some unintended and unwanted consequences, including significant increases in the cost of servicing, a suboptimal servicing system, reduced access to credit for consumers, and an exodus from the industry by depository servicers.

To address this policy oversight, the Urban Institute's Housing Finance Policy Center (HFPC) has convened the Mortgage Servicing Collaborative (MSC) to elevate the mortgage servicing discussion and facilitate evidence-based policymaking by bringing more data and evidence to the table.[1] The MSC has convened key industry stakeholders—lenders, servicers, consumer groups, civil rights leaders, researchers, and government—and tasked them with developing a common understanding of the biggest issues in mortgage servicing, their implications, and possible solutions and policy options that can advance the debate. And with the mortgage industry no longer operating in crisis mode, we believe now is the right time for this effort.

About the Mortgage Servicing Collaborative

The Housing Finance Policy Center's Mortgage Servicing Collaborative is a research initiative that seeks to identify and build momentum for servicing reforms that make the housing market more equitable and efficient.

One core MSC objective is to improve awareness of the role and importance of mortgage servicing in the housing finance system. Since 2013, HFPC researchers have studied the landscape, followed the work and policies put in place after the crisis, and assessed the impact of the servicing industry on consumers and communities. This includes loss mitigation and foreclosure actions and how servicing practices affect access to credit through tight underwriting standards. The Urban Institute has analyzed and convened forums on emerging issues in mortgage servicing, including calls for reforms, the impact of mortgage regulation, the rise of nonbank servicers, and the implications for consumers and communities. We determined that a focused effort that involves external stakeholders and resources could lead the way in developing policy and structural recommendations and bring visibility to the important issues that lie ahead.

The MSC has convened key industry stakeholders—including lenders, servicers, consumer groups, civil rights organizations, academics, and regulators—to develop an evidence-based understanding of important factors and to develop and analyze solutions and implications with a well-rounded and actionable orientation.

The MSC seeks to

- bring new evidence, data, and recommendations to the forefront;
- foster debate and analysis on issues from regulatory reform, technology innovations, cost containment, and consumer access to mortgages; and
- produce and disseminate our research findings and policy recommendations—including perspectives by MSC members—to offer policy options that can clarify and advance the debate and ensure servicing is addressed in broader housing finance reform.

For more information about the MSC or to see other publications, news, and products, visit the MSC program page, https://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-servicing-collaborative.

Mortgage Servicing Collaborative Participants

- AmeriFirst: Mark Jones and Greg Warner
- Bank of America: Terry Laughlin and Larry Washington
- Bayview: Rich O'Brien and Julio Aldecocea
- Black Knight Financial Services: Joseph Nackashi
- Caliber Home Loans: Tricia Black, Marion McDougall, and Lori Foster
- Colonial Savings: David Motley and Jane Larkin
- Genworth: Steve Hall and Carol Bouchner
- Guild Mortgage Company: David Battany
- Housing Policy Council and Hope Now: Paul Leonard, Meg Burns, and Eric Selk
- JPMorgan Chase: David Beck, Ramon Gomez, Erik Schmitt, and Diane Kort
- Katie Porter: Faculty at University of California, Irvine
- Mortgage Bankers Association: Justin Wiseman, Mike Fratantoni, and Sara Singhas
- Mr. Cooper: Jay Bray and Dana Dillard
- National Community Stabilization Trust: Julia Gordon
- National Fair Housing Alliance: Lisa Rice
- Northern Ohio Investment Corp.: Mark Vinciguerra
- Ocwen: John Britti and Jill Showell
- Patricia McCoy: Faculty at Boston College
- PennyMac: David Spector and Karen Chang
- PricewaterhouseCoopers: Sherlonda Goode-Jones, Peter Pollini, and Genger Charles
- Quicken Loans: Mike Malloy, Pete Carroll, and Alex McGillis
- Self Help Credit Union/Center for Responsible Lending: Martin Eakes and Mike Calhoun
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- Union Home Mortgage: Bill Cosgrove
- U.S. Bank: Bryan Bolton
- Wells Fargo: Brad Blackwell, Raghu Kakumanu, and Laura Arce

In this brief, the first in a series prepared by HFPC researchers with the collaboration of the MSC, we review how we arrived at the present state of affairs in mortgage servicing and explain why it is important to institute mortgage servicing reforms now.

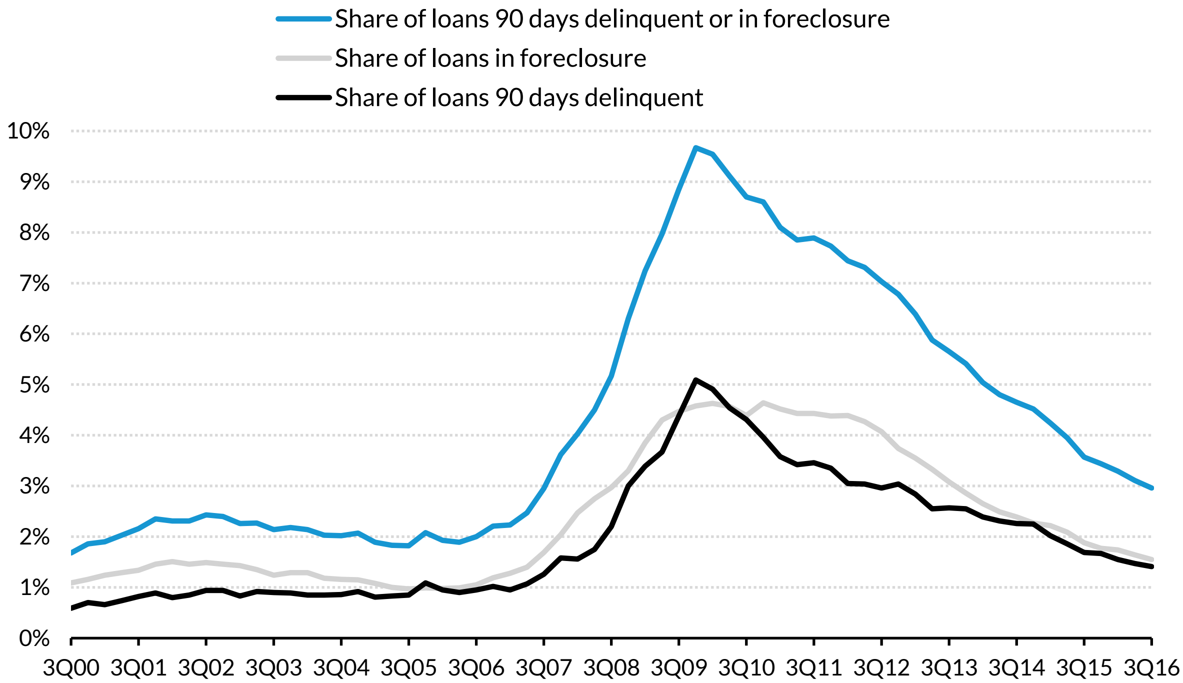
The Current Mortgage Servicing Landscape

To understand the current servicing environment, we must understand how it functioned before the foreclosure crisis (Kaul and Goodman 2016). Before 2007, servicing consisted primarily of processing homeowners' mortgage payments with a set of monthly tasks: generating monthly statements, collecting payments from borrowers, and keeping track of fees and escrow items. Most homeowners made their payments in full and on time. For the small share of borrowers that went delinquent, servicers were required to engage in "loss mitigation" to minimize losses for the entity backing the loan, such as the Federal Housing Administration (FHA), US Department of Veterans Affairs (VA), Fannie Mae, Freddie Mac, or a private investor. This was achieved either by getting the borrower to resume monthly payments or by a foreclosure sale, whose proceeds would pay off the loan. Low default rates also meant that servicers deployed a limited operational infrastructure for loss mitigation. Servicing thus received little attention from policymakers and the public and was primarily viewed as a straightforward function in the complicated housing finance system.

The foreclosure crisis in 2007 upended the precrisis servicing model. Servicers were still responsible for collecting and processing borrower payments and for minimizing losses for investors. But the number of borrowers who needed mortgage payment assistance skyrocketed in a short period and raised awareness of mortgage servicing to a level where it became a focus for policymakers. Rising delinquencies brought two new issues to the forefront: (1) the difficulty of ramping up servicing operations to meet significantly increased volume and (2) lack of adequate loss mitigation options.

FIGURE 1

Loans in Serious Delinquency or Foreclosure



Sources: Mortgage Bankers Association and the Urban Institute.
Note: 3Q00 = third quarter of 2000.

In recognition of the need to improve loss mitigation and help borrowers stay in their homes, several federal entities—including Fannie Mae, Freddie Mac, the FHA, the Consumer Financial Protection Bureau, the federal prudential banking regulators, and the US Department of the Treasury—devised new loss mitigation programs (e.g., the Home Affordable Modification Program). New servicing rules and guidelines were also put in place, significantly affecting servicing operations. Although these requirements existed before the 2008 crisis, they were less comprehensive. In the precrisis model, investors granted servicers flexibility to account for the unique needs of an individual borrower, and in some cases, there were limited options for loss mitigation, especially for payment-reducing modifications. Borrowers moved from default to foreclosure status if they could not pay their mortgages in a timely manner. The new rules established requirements for every step of the process, including how and when to contact a borrower and what loss mitigation options to offer and in what order.

Although the new rules increased standardization, many rules were not aligned among investors, creating different servicing protocols depending on who owned, insured, or guaranteed the mortgage. The insurer or guarantor of the loan (e.g., the FHA, VA, US Department of Agriculture, Fannie Mae, or Freddie Mac) or a private investor is responsible for creating the rules that minimize losses for its portfolio. Depending on the investor, insurer, or guarantor, there can be large variation in the assistance a servicer can offer a distressed homeowner. Two homeowners living next door to each other and facing similar hardship could be offered completely different loss mitigation products from the same servicer.

The Importance of Loss Mitigation

The period following the housing crisis was a time of distress for borrowers and communities. Because of the substantial rise in the number of delinquent borrowers and nationwide house price declines, working with servicers to obtain payment assistance, generally in the form of loan modifications, became important. There was often confusion about the relief options available, leading to delayed or inadequate assistance. In addition, early versions of new loan modification programs required substantial and time-consuming adjustments to maximize effectiveness. Many mortgages failed to cure (i.e., become current again), and many properties lost value. Additionally, many borrowers had risky subprime loan products that were governed by proprietary servicing agreements that made it difficult to modify the loans. By the time some of these issues were addressed, many more borrowers had entered default or foreclosure, some of which could have been prevented.

These experiences helped the nation's servicing system and policymakers learn important lessons, including the importance of efficient loan modifications offering meaningful payment relief. A loan modification is a permanent change in the original terms of the mortgage. It typically involves a combination of term extension, rate reduction, and principal forbearance. The goal is to reduce the monthly payment to a more affordable level and help cure the default. Crisis-era loan modifications were helped by falling interest rates across the board, which made it less expensive for investors to reduce monthly payments. This raises an important implication for the future of loan modifications. As interest rates rise, many borrowers with postrecession, ultra-low-rate government-insured mortgages who become delinquent may not see reduced payments under current loan modification products, which rely heavily on interest rate reduction. Members of the MSC agree this is a major issue that needs to be addressed. The second brief under the MSC umbrella will examine this issue.

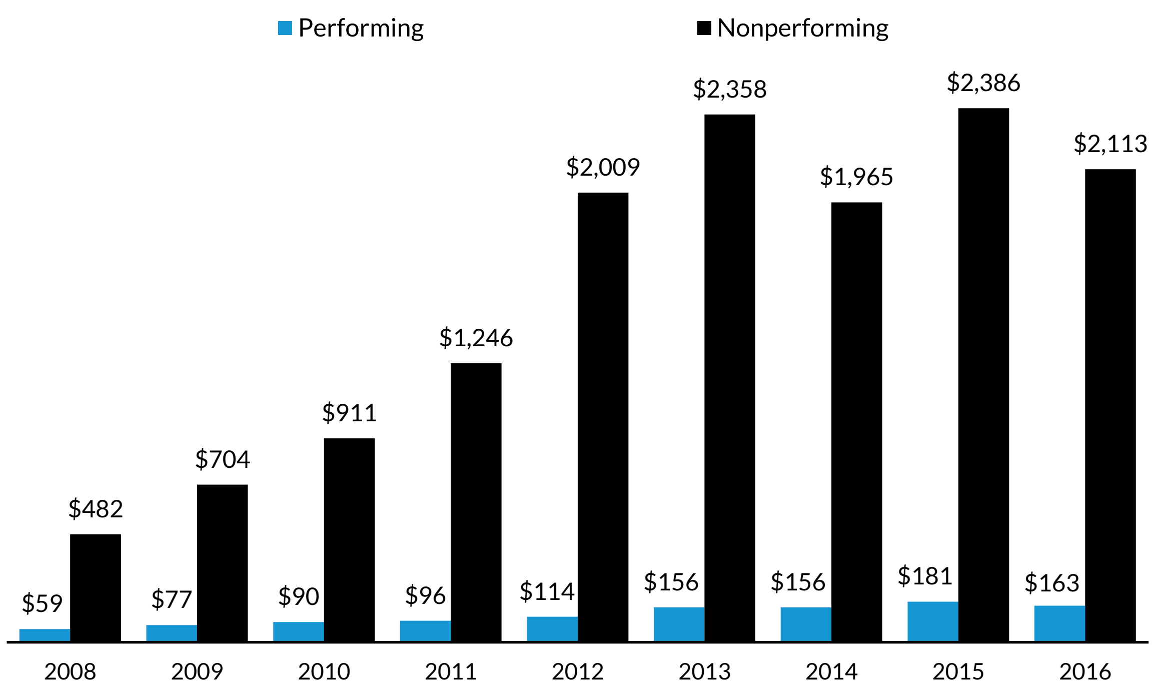
When loan modifications and other home retention options fail to cure a delinquency, servicers look at foreclosure alternatives, such as short sales and deeds in lieu of foreclosure, as the next options. These tools allow borrowers to exit their homes without going through time-consuming and expensive foreclosures. If these options fail to resolve the delinquency, the servicer must begin foreclosure proceedings. For FHA-insured mortgages, foreclosure is even more expensive and time consuming because servicers must repair foreclosed properties after auction and convey them to the FHA. It takes more than a year to convey a foreclosed property to the FHA, resulting in substantial property preservation and other expenses, for both the FHA and the servicers. Reforming the FHA's foreclosure and conveyance process could thus result in significant cost savings for the FHA and the Mutual Mortgage Insurance Fund. The third MSC brief will examine these and related issues concerning the FHA's foreclosure and conveyance processes and offer recommendations to reduce loss severities for the FHA, reduce unnecessary costs for servicers, and improve outcomes for borrowers and neighborhoods.

The Risks of Inefficient Servicing

The risks of an inefficient mortgage servicing system are borne by consumers, neighborhoods, government, and the industry. The costs of servicing mortgage loans have increased since the 2008 foreclosure crisis.[2] Between 2008 and 2016, the per loan cost of servicing a "nonperforming" loan, one that is either delinquent or in default, has more than quadrupled, from $482 to $2,113. The cost of servicing a "performing" loan, one for which the borrower is not behind on payments, has nearly tripled, from $59 to $163, according to the Mortgage Bankers Association's survey of mortgage servicers.[3]

FIGURE 2

Servicing Costs per Loan, Performing and Nonperforming Loans



Source: Mortgage Bankers Association Servicing Operations Study and Forum.

These increasing costs negatively affect all stakeholders in the housing finance system.

Consumers

For consumers with mortgage loans, servicers are the touch point throughout the mortgage cycle. Consumers need servicers who can assist them through a difficult and complicated delinquency. As the costs of servicing nonperforming mortgages has increased, some lenders have reduced lending or raised lending costs to first-time homeowners and low-to-moderate-income borrowers out of concern that these borrower segments present a higher likelihood of default. This is particularly the case for the FHA, which insures loans to these groups. Improving servicing efficiency and reducing servicing costs will keep more consumers in their homes, encourage more lenders to remain active in the FHA space, and reduce the incentive to curtail access to credit.

Mortgage Servicing Industry

The high costs of servicing have a direct impact on servicers' bottom lines. Because of this and other reasons, the servicing industry is dealing with an exodus of servicers, especially depository institutions.[4] Many large, federally regulated depository financial institutions have pulled back from the mortgage market in recent years. This void is being filled by "nondepository institutions," whose market share has grown substantially, especially within the FHA space (State Street and HFPC 2017, 30). Absent this growth, access to credit would be tighter and servicing capacity more limited. Another recent development is the rise of subservicing, an arrangement under which the entity that owns mortgage servicing rights subcontracts the servicing of the loan to another entity with more specialized skills or a more efficient servicing infrastructure. The unpaid principal balance of servicing that is subserviced has more than doubled from about $900 billion in 2013 to more than $2 trillion today, according to Inside Mortgage Finance. Reforming and simplifying mortgage servicing could reduce the cost of servicing, improve economics of the servicing business, and motivate institutions that have shrunk their footprint to consider returning.

Federal Regulators, Insurers, Guarantors

Federal agencies create and enforce mortgage servicing rules and regulations. These agencies regulate four main risks: systemic risk, solvency risk, market conduct risk, and investor risk. The Federal Reserve Board and the Financial Stability Oversight Council supervise mortgage servicing for systemic risk. The federal prudential banking regulators (including the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation) regulate mortgage servicing for solvency risk. The Consumer Financial Protection Bureau and the Federal Trade Commission oversee mortgage servicing for market conduct risk to borrowers. Finally, federal mortgage guarantors (primarily Fannie Mae, Freddie Mac, and Ginnie Mae) and insurers (FHA, VA, and the US Department of Agriculture) impose mortgage servicing rules to minimize their own credit and counterparty risk. Bringing loans that experience distress back to current status is critical for these entities because the longer loans stay in delinquency, the greater the losses are for the entity backing the loan.

Housing Counselors

More than 2,000 US Department of Housing and Urban Development–approved housing counselors work in the nation's states and territories. Primarily nonprofits and housing counselors help borrowers succeed at homeownership by counseling them on financial management and other necessary steps to continue paying their mortgages. Consumers trust their housing counselors and turn to them when they experience financial hardships. The housing counselor is the consumer's advocate, interfacing with the servicer to help the borrower catch up on payments. Because housing counselors advocate for the best solutions for borrowers, they benefit from more efficient and effective mortgage servicing.

Research to Enable Sound Policy

Mortgage servicing today is much more complex, tightly regulated, and sophisticated than precrisis servicing. The housing crisis taught us that the quality of mortgage servicing influences the health of the broader housing market. And because the housing market constitutes approximately 15 percent of the nation's economy, an effective mortgage servicing system is critical to strong regional economies and to a thriving national economy.

Although experts recognize that mortgage servicing is complicated and expensive, research on the negative impact of this complexity and cost is sparse. We need to better understand how we can simplify and streamline servicing, reduce servicing costs, and create better outcomes for borrowers. Because mortgage servicing is often not central to discussions about major housing policy debates, it is imperative that this critical function be better understood. And because most of the postcrisis regulatory overhaul is behind us, because delinquencies are low, and with housing finance reform legislation once again in the works in Congress, now is the right time for servicing reforms.

To that end, HFPC is releasing a series of publications in 2018 based on the work of its Mortgage Servicing Collaborative that examine key servicing issues and provide recommendations for resolving them. This introductory brief sets the stage by explaining the importance of mortgage servicing to the overall health of the housing market. Upcoming publications will analyze specific areas where reforms to current policies could improve servicing efficiency and create a win-win for government insurers, industry, and consumers. These upcoming briefs will include the following:

- **Loan modifications for government-insured loans.** This brief will examine issues concerning the efficacy of government (FHA, VA, US Department of Agriculture) loan modifications in a rising rate environment. When a delinquent borrower obtains a loan modification, the mortgage rate is typically reset to the prevailing market rate, which can be higher or lower than the original note rate. When the market rate is lower than the original rate, providing payment reduction becomes inherently easier and less expensive. When the market rate is higher than the note rate, providing payment reduction becomes more expensive, making it more difficult to cure the delinquency. In this brief, we offer recommendations to ensure continued availability of effective loan modifications in a rising interest rate environment.
- **The FHA's foreclosure and conveyance process.** Relying on proprietary data shared by servicer members of the MSC, this brief will examine the FHA's foreclosure and conveyance processes. This brief will outline key findings from the data we collected and offer recommendations to simplify and streamline these processes to reduce loss severities for the FHA, reduce costs for servicers, and improve outcomes for borrowers and neighborhoods.

The recommendations made in upcoming MSC publications will offer opportunities to improve mortgage servicing. These changes center on the government agencies that backstop mortgage loans and could be addressed as part of the housing finance reforms and policy enhancements discussed in the near future. The Mortgage Servicing Collaborative and the Urban Institute's Housing Finance Policy Center welcome the opportunity to engage in meaningful deliberations and discussion with all stakeholders.

Notes

1. For more information about the Mortgage Servicing Collaborative, see "The Mortgage Servicing Collaborative," Urban Institute, Housing Finance Policy Center, accessed December 28, 2017, https://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-servicing-collaborative. For a glossary of relevant terms, see "Mortgage Servicing Glossary," Urban Institute, Housing Finance Policy Center, accessed January 5, 2018, https://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-servicing-collaborative/mortgage-servicing-glossary.
2. Marina Walsh, "MBA Chart of the Week: Servicing Costs per Loan (Single-Family)—Performing v. Nonperforming," *MBA Newslink*, July 24, 2017, https://www.mba.org/mba-newslinks/2017/july/mba-newslink-monday-7-24-17/residential/mba-chart-of-the-week-servicing-costs-per-loan-(single-family)-performing-v-non-performing.
3. These costs can vary from servicer to servicer depending on the share of delinquent loans in portfolio, the share of these loans in judicial versus nonjudicial foreclosure states, share of conventional loans versus government loans, and overall servicer efficiency.
4. Karan Kaul, Bing Bai, and Laurie Goodman, "Five Things Every Policymaker Should Know about Nonbanks and the Evolving Mortgage Industry," *Urban Wire* (blog), Urban Institute, September 5, 2017, https://www.urban.org/urban-wire/five-things-every-policymaker-should-know-about-nonbanks-and-evolving-mortgage-industry.

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About the Authors

Laurie Goodman is codirector of the Housing Finance Policy Center at the Urban Institute. The center provides policymakers with data-driven analyses of housing finance policy issues they can depend on for relevance, accuracy, and independence. Before joining Urban in 2013, Goodman spent 30 years as an analyst and research department manager at several Wall Street firms. From 2008 to 2013, she was a senior managing director at Amherst Securities Group LP, a boutique broker-dealer specializing in securitized products, where her strategy effort became known for its analysis of housing policy issues. From 1993 to 2008, Goodman was head of global fixed income research and manager of US securitized products research at UBS and predecessor firms, which were ranked first by *Institutional Investor* for 11 straight years. Before that, she was a senior fixed income analyst, a mortgage portfolio manager, and a senior economist at the Federal Reserve Bank of New York. Goodman was inducted into the Fixed Income Analysts Hall of Fame in 2009. Goodman serves on the board of directors of the real estate investment trust MFA Financial, is an adviser to Amherst Capital Management, and is a member of the Bipartisan Policy Center's Housing Commission, the Federal Reserve Bank of New York's Financial Advisory Roundtable, and Fannie Mae's Affordable Housing Advisory Council. She has published more than 200 journal articles and has coauthored and coedited five books. Goodman has a BA in mathematics from the University of Pennsylvania and an MA and PhD in economics from Stanford University.

Alanna McCargo is codirector of the Housing Finance Policy Center at the Urban Institute, where she focuses on center development and strategy, including the cultivation of innovative research partnerships and initiatives within Urban and with external stakeholders. She is also executive director of Urban's Mortgage Servicing Collaborative. Before joining Urban, McCargo was head of CoreLogic Government Solutions, working with federal and state government agencies, regulators, government-sponsored enterprises, and universities to deliver custom data, analytics, and technology solutions to support housing and policy research. Previously, she held leadership roles with Chase and Fannie Mae, managing mortgage product development, servicing portfolios, policy efforts, and mortgage servicing transformation and alignment efforts. From 2008 to 2011, she worked on behalf of the US Treasury Department on implementing federal housing programs, including the Making Home Affordable loss mitigation and foreclosure prevention initiatives with lenders, servicers, and investors nationwide. McCargo has a BA in communications from the University of Houston and an MBA from the University of Maryland.

Karan Kaul researches topical housing finance issues to highlight the market impact of ongoing regulatory, industry, and related developments. He is also responsible for monitoring and reporting on mortgage market trends and current events weekly. He brings a deep understanding of key reform issues, political landscape surrounding reform, and pros and cons of different approaches concerning their impact on mortgage rates, credit availability, private capital, and other factors. He holds a bachelor's degree in electrical engineering and a master's degree in business administration from the University of Maryland, College Park.

Todd Hill is the policy and research program manager at the Urban Institute's Housing Finance Policy Center. He manages and coordinates all aspects of the center's high-profile programs and research. Previously, Hill served six years as senior director of government affairs at the Financial Services Roundtable's Housing Policy Council

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Sheryl Pardo is the associate director of communications in the Housing Finance Policy Center at the Urban Institute, where she ensures that the center's impartial data and expert analyses are readily available to and understood by policymakers and the general public. She helps researchers make their work accessible in blog posts and newsletters and through social and traditional media outlets. Before joining Urban, Pardo was a strategic communications expert for several for- and nonprofit organizations. At the Mortgage Bankers Association, she developed communications strategies and compelling content for the government affairs and executive offices. She also designed and conducted a competitive assessment and directed an internal strategic planning process for senior leadership and the board of directors. At the US Department of Housing and Urban Development, where Pardo was a senior adviser, she oversaw all speechwriting activities for housing secretary Andrew Cuomo and worked on various multifamily issues for Federal Housing Administration commissioner William Apgar. She is a licensed attorney and practiced environmental law in San Francisco for five years. Pardo holds an AB in East Asian studies from Harvard University and a JD from Cornell University.

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