

# SERVICING MANAGEMENT®

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## A Granular Analysis Can Propel REO Strategies

*Making informed loss mitigation and property disposition decisions involves delving deeply into the realities of a property's market.*

BY JON DAVIS

As mortgage defaults, foreclosures and real estate owned (REO) inventories continue to rise nationwide, servicers must become more keenly focused on loss mitigation efforts - making smart choices on a property-by-property, loan-by-loan basis.

Unfortunately, those choices aren't always immediately clear. To make the best decisions for investors and borrowers alike, servicers need the most detailed information available about a property, its valuation and localized market trends.



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Today, servicers can turn to data and analytical models for a much more granular view of the properties in their portfolios. By drilling down to a neighborhood level, servicers can gain an informed understanding about a given property's value today and where it's likely to go in the near future.

Given the extended timelines associated with foreclosures and REO sales, valuation changes can have a profound effect on a lender's potential losses. Having access to this level of granular, forward-looking information can help servicers make better default resolution decisions and minimize losses.

### **Deciding to dispose**

Obviously, it's always preferable to keep the borrower in the home and resolve delinquency issues quickly. If a loan modification or repayment

plan is possible, it's usually the best option for everyone involved. But workouts aren't always possible, and sometimes these efforts merely prolong the inevitable, masking deeper problems that will ultimately drive the property into foreclosure.

In such cases, loss mitigation activity can be better referred to as pre-foreclosure activity. By delaying the recognition of potential problems with a property, ill-advised loss mitigation efforts serve to further inflate the bubble of properties heading into foreclosure. Servicers must, therefore, closely monitor early loan performance with an eye toward any visible deterioration.

If monitoring indicates a higher ratio of loans becoming delinquent than improving, it's an obvious sign that foreclosures will increase in the future. In that case, the servicer must immediately become more aggressive with its REO disposition strategy. But how does the servicer know that the decisions it's making are relevant to the individual property itself?

If nationwide, 30% more loans are going delinquent instead of improving, that doesn't necessarily hold true in individual markets throughout the country. In reality, for some markets, the opposite will be true, while for others, the ratio may be even worse.

To make individually informed loss mitigation and property disposition decisions, servicers have a need to drill down as deeply as possible for the most granular level of detail on a particular property and the reali-

ties of its equally particular market environment. And, given the volume that the servicing industry has coming down the pipe over the next year, it's increasingly important for them to get that detail today.

### **Analytical models**

When all is said and done, every asset is unique, and servicers need to assess them accordingly. Analytical models are capable of incorporating a wide variety of data sources to drill down to a localized, neighborhood level of property information. With these tools, servicers are able to gain a granular level of detail through a combination of metrics and statistics that have not been previously commingled.

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These models are able to paint the most complete picture of a property, going beyond a metropolitan statistical area or ZIP code level, by focusing in on its particular neighborhood. They can report on market trends and property values for a given neighborhood with projections over the next four quarters. Results are calculated through

a complex analysis of neighborhood housing supplies, delinquencies and foreclosures.

Market data - including sales, non-sales and listing cancellations - are retrieved from multiple listing services and public-record data, which can be combined with REO sales information to accurately project near-term trends.

This type of report specifically informs the servicer of what the market is doing - from a variety of perspectives - in a given neighborhood. Trends can be seen for particular property types within that neighborhood - a level of detail that is essential in determining the best decision for a specific property, be it delinquent, at some point in the foreclosure process or one on which the bank is evaluating a short sale. The whole point is to give the servicer neighborhood-specific data that can impact property valuation and, therefore, loss mitigation strategies.

The result of bringing these disparate pieces of information together far outweighs the sums of its parts. The greatest challenge is in defining the neighborhood itself. There are several ways to go about achieving this definition, and some are more accurate than others. For example, ZIP codes or census tracts could be used. But to accurately reflect a neighborhood - an amorphous definition that can vary greatly from one locality to another - true boundaries must be defined.

Technology available today - in conjunction with local, human expertise - can define a neighborhood at a very detailed level. For any given area, a local valuation expert can use this technology to draw a polygon around the neighborhood boundary however it is locally defined.

Additionally, for the rare occasion when a local expert is unavailable, automatic fallback systems can still define neighborhoods more accurately than by ZIP code. Once a subject property neighborhood has been truly defined, it then becomes possible to layer different data valuations and mortgage performance information for that neighborhood.

With neighborhood boundaries defined, the servicer can begin examining specific property information, neighborhood valuation trends and mortgage performance, fed by as many distinct data sources as possible. This

is where forward-looking servicers will gain the greatest edge.

### **Improved decision-making**

Servicers can gain numerous benefits from neighborhood-level analytics that draw from the widest variety of data sources. They can see clearly whether the housing supply in a given neighborhood will expand or contract over the next year - an ability that can have a distinct impact on strategic decisions.

If, for example, the market is going to be flooded with new REO properties in the next six months, it may make sense for the servicer to attempt a short sale and dispose of its REO inventory as quickly as possible to avoid potential future losses. On the other hand, if the servicer sees that the supply will contract during that same pe-

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riod, it may choose to take a slower approach to the foreclosure process, knowing that there will be less inventory in the future and the property would be easier to sell.

Granular data and analytics give servicers inside market knowledge that can help them determine whether it's best to hold or sell a property at a given point in time.

Servicers also gain insight into neighborhood property valuation trends, focusing in on absorption rates. If the absorption rate is increasing (i.e., fewer homes are being sold while more are coming on the market), the servicer will know that its inventory is likely to rise. Advanced analytics reveal the nuances of the market in terms of supply and demand. Whether demand is increasing, decreasing or staying the same, it is all reflected in property valuations.

Knowing the likely value of competing properties over the next six months to a year can help the servicer make a more informed decision about the subject properties in its portfolio.

Also, employing analytical models that take REO discount rates into account can assist servicers with effective loss mitigation strategies. A granular level of detail on a given neighborhood can likewise lead to a very specific discount rate, which allows the servicer to price the property accordingly to achieve a timely disposition without leaving money on the table.

Moreover, this level of detail can serve as a quality control measure for servicers. For example, a servicer may get a broker price opinion that suggests a 10% discount rate is needed to achieve a timely sale. However, looking at the granular detail for that particular property may point to a glut of properties on the market, declining valuations or a rising absorption rate, indicating that a 20% discount rate is probably more in order.

Lastly, and obviously, there are benefits to the borrower as well. When the servicer has an objective, informed understanding of the market realities and loss potential, it often becomes clear that the best option would be to keep the borrower in the home and pursue an actionable workout strategy that will not prolong the inevitable, but instead work to the benefit of the investor and homeowner alike.

In a volatile neighborhood market, if the analysis points to the housing supply decreasing in the near future, that is a perfect opportunity to keep the borrower in the property and making payments, and it also provides an opportunity for the market to reverse a negative equity position.

Without access to data and analytics at this most granular level, the servicer wouldn't be in the position to know the best route to take. Conversely, the forward-looking servicer with such access gains a distinct competitive edge and can rest assured that decisions are being made based on the most comprehensive and detailed possible analysis of a specific property, minimizing its loss potential and maximizing its options.

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