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IT'S ALL ABOUT HAVING THE RIGHT CONNECTIONS

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A Lawyer's Perspective

Foreclosure Interests

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In my training as a mediator, I was taught to first determine the interests of the parties and then work with them to create a resolution that addresses not only their own interests, but those of the other parties to the dispute. Before you can "mine" a party's interests, you must first determine the parties. To determine all of the parties, one must first determine the key elements of the dispute. The mediator must then listen carefully to the parties to be able to help create an equitable balance of those interests. In an attempt to determine the parties and their interests, I had several discussions with industry participants and was surprised by what I learned.

One of the key parties in a foreclosure workout appears to be the servicer. The servicer is the company to which you send your mortgage payment. I had previously been of the opinion that the servicer was always a minor player in the foreclosure and workout process. Based on background discussions with an industry expert, I now understand that this is not necessarily so. Here's why.

A mortgage is created by an originator. The originator can be a correspondent for another entity or an institution. Institutional originators range from local and community institutions to national entities. An institutional originator can hold the mortgage as an investment or it can sell the mortgage, in whole or in part.

The industry considers a mortgage as having two key components: servicing; and, the repayment of the amount borrowed, plus interest, known as the asset. Each component creates cash flows for whoever controls it. The current holder of the mortgage and the potential buyer negotiate their deal based on those cash flows.

Mortgage loan deals are not based on a homogeneous product, but rather on the quantity and quality of future cash flows much as with investment real property, a stock or a bond. Industry experts negotiate specific deal points that often vary significantly from deal to deal. Most loans are sold in packages and the terms of the sale would usually, but not always, be the same for every loan in the package.

In the sale of a loan package, the seller may decide to keep servicing rights, including the right to foreclose and/or to determine the terms of a work-out. Alternately, the seller may only retain the right to collect the mortgage payment and/or manage real estate tax and insurance escrows.

Workout rights may be further parsed into the various decisions that may have to be made in the workout or foreclosure process. Seller retention of only minor changes in the repayment schedule, such as the ability to grant a payment grace period, would cause a loan package to be priced differently from a deal in which the right to mortgage modification is retained. But then, mortgage modification deal element variations would affect the value of the loan package and could include revision of the mortgage interest rate, payment amount, when the principle is due, and treatment of foregone amount, such as in a balloon at the tail end of the amortization period.

The key to a foreclosure workout, then, is to determine who owns what specific workout rights for the specific issues that need to be addressed in a particular foreclosure. There is no "one size fits all". And, that appears to be part of the reason for the uncertainty in the foreclosure crisis. The disparate interests of disparate parties have created undeterminable permutations in structuring individual homeowner workouts. And that's without consideration of any the tax ramifications.

One means of addressing the interests of the holders of rights under existing loans is to extinguish them by paying off the old loan and creating a new one. The FHA Hope for Homeowners (H4H) program, as previously reported in this column, is intended to resolve this dilemma by creating a new FHA-insured mortgage, as part of a workout.

Unfortunately, the program does not adequately address the financial interests of the lenders, according to Bill Malamut, president of Atlantic Coast Mortgage, in Pleasantville. Bill's company has reportedly been the highest volume producer of FHA loans in Atlantic and Cape May counties for years. Since the introduction of this program Oct. 1. Bill's high volume FHA loan operation has not processed even one FHA H4H loan. His experience is not unusual. The Wall Street Journal reported that in the first two weeks after the program began, only 42 applications were filed nationally.

Bill Malamut believes that this is because the program requires the lender to write down a portion of the principal with a maximum 90 percent loan to value. Under the H4H program, HUD owns appreciation in the property in an amount declining from 100 percent in year one to 50 percent in year five. According to the Wall Street Journal, Thomas Lawler, a leading national economist stated: "The only reason you would do a principal write-down under the (H4H) program is if you think property values are going to continue to go down." (As this article was going to publication, HUD announced a major revision of the H4H program to address the above issues).

The foreclosure problem will not be resolved unless policy-makers address the interests of the parties. That includes a reasonable satisfaction of the interests of whatever parties hold the rights affected by a workout or loan modification.

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