CALIFORNIA MORTGAGE PROTECTION SERVICES INC.
A LOSS MITIGATION COMPANY

Persistence Pays Off When Loan Modification Saves House and Credit

By Jack Guttentag

Saturday, October 20, 2007; Page G04

A loan modification is a change in the loan contract agreed to by the lender and the borrower. The modifications getting attention now are those designed to reduce the payment burden on borrowers faced with impending interest rate increases that will make monthly payments unaffordable to them. Many are subprime borrowers.

Homeowners faced with this prospect, whether they are delinquent or not, should request a modification.

You are unlikely to get such a change if you don't ask, and you should make the investment required to make the case. The stakes are very high: your house and your credit.

In most cases, the decision on a modification is not made by the firm that owns the loan. It is made by a firm servicing the loan under contract to the owner. The owner could be a single lender, or it could be a group of investors who own pieces of a mortgage-backed security collateralized by a pool of loans.

Whoever owns the loan, the servicing firm is contractually obligated to find the solution to payment problems that will minimize loss to the owner. If the lowest-cost solution is a contract modification, that's great -- everyone involved prefers a modification instead of a foreclosure. But if a foreclosure would generate lower costs for the owner, the decision will be to foreclose. The cost of foreclosure to the borrower does not enter the decision.

Yet the decision is far from cut and dried, and it can be materially affected by whether and how the borrower presents his case. I discussed this issue with Warren Brasch, a lawyer who represents borrowers seeking loan modifications. Our combined observations:

Equity: Perhaps the most important factor affecting the modification decision is the amount of equity the borrower has in the property. If the borrower has enough equity in the property to pay any deferred interest plus foreclosure expenses, foreclosure is almost bound to be the lower-cost solution.

Equity depends on property value, which the borrower is much better positioned to know than the servicer. The borrower knows or can easily find out how many houses in the neighborhood are for sale and what the trend has been in recent sale prices. In a weakening market, it is easy for the lender to overestimate value, and the borrower must prevent that.

Moral hazard: Servicers fear that if they are liberal in granting modifications, borrowers who don't need a modification will seek one anyway. They protect themselves against this by entertaining modification proposals on a case-by-case basis, while placing the burden of proof on the borrower.

Borrowers must accept the burden of proof. In addition to the data on property value, they need to document that they cannot afford the payment increase that is pending, and they must document what they can afford.

To do so, borrowers should calculate their total debt ratio: the sum of mortgage payment, other debt payments, property taxes and homeowner's insurance as a percent of their gross (before tax) income.

This number should be calculated as it stands now and as it would be after the rate adjustment. It should also be calculated to demonstrate what the borrower can afford. On the last, Brasch suggests that a servicer may be willing to accept 45 percent as a reasonable maximum.

Servicing cost: Servicers have an interest in minimizing modifications because they add to costs. They try to keep costs down by computerizing the servicing process to the greatest degree possible and standardizing customer support procedures so that low-paid and easily trained employees can perform them.

Modifications must be handled by a special group who are more highly trained and better-paid, and the increased cost of expanding their number cuts into the bottom line. Hence, there is a tendency to be nonresponsive in the hope that the borrower will go away.

Borrowers have to be persistent. Brasch said: "If a servicer says they will call you back . . . forget about it. You need to call them and call them constantly. They will lose your paperwork, fail to return calls, put you on hold and then hang up. It's what they do. Keep fighting, calling, faxing. This does work!"

In deciding whether a modification would be less costly than a foreclosure, servicers usually ignore an asset possessed by the borrower that could tilt the balance toward modification. This is the right to future appreciation in the value of the borrower's house.

In exchange for a modification that might otherwise be more costly to the owner than a foreclosure, the borrower could pledge a percent of the future appreciation, which could shift the balance to modification. I will discuss that next Saturday.

Jack Guttentag is professor of finance emeritus at the Wharton School of the University of Pennsylvania. He can be contacted through his Web site,http://www.mtgprofessor.com.

Distributed by Inman News Features