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Proactively Managing Residential Mortgage Risk in Today's World

Lending Best Practices as Forbearance, Loan Modifications and Default Rates Rise

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The real estate market over the past three years has been an unpredictable mix of ups and downs. The crisis stemming from the Covid-19 pandemic created significant volatility in the real estate market. In March 2020, the Department of Housing and Urban Development (HUD) was ordered to suspend all evictions and foreclosures for 60 days, providing much-needed relief for homeowners. Under the CARES Act, affected borrowers with federally backed mortgage loans could defer their mortgage payments for up to 180 days and have the right to apply for another six-month extension. As a result, default rates saw all-time lows in 2020-2021.

During that time, mortgage interest rates plummeted, refinancing skyrocketed and housing inventory became scarce as everyone rushed to take advantage of the lower rates and work-from-anywhere opportunities. The real estate market was booming and forced lenders to keep up with the pace of change, and adopt new technologies to support remote appraisals, title and closing.

Then, in the blink of an eye, the market shifted.

Moratoriums and forbearance protections from the pandemic have phased out. The Federal Reserve repeatedly hiked interest rates throughout 2022, and rates continue to remain high for the foreseeable future. According to the latest reports from Freddie Mac, the average 30-year, fixed-rate mortgage was 6.15% for the week ending January 19, 2023, down from 6.33% in the previous week.

A looming economic downturn could be on the horizon, according to more than two-thirds of the economists at 23 large financial institutions. Unemployment is expected to rise, inflation continues to tighten budgets and personal savings rates have fallen to about 5% (compared to 7% before the pandemic.

Uncertainty is in the air, and many experts are speculating that forbearance requests, delinquencies and defaults will rise with economic tides.

Fitch Ratings anticipates the delinquency rate will be volatile, particularly during the first half of 2023, but it will remain below the pandemic peak of 4.98%. Black Night's First Look at November 2022 Mortgage Data sheds light on the current environment stating:

- Prepayment activity in November dropped 15.6% to a single month mortality (SMM) rate of 0.40% – once again marking the lowest rate on record since before 2000
- The national delinquency rate rose another 3.5% in November to 3.01%, up 10 basis points since October, driven by a 31K (+3.9%) increase in 30-day delinquencies and a 25K (+11%) rise in 60-day delinquencies
- Active foreclosure inventory rose 5.3%, though 2022 volumes remain subdued after the record lows of 2021 due to widespread moratoriums and forbearance protections

Current research has made it clear that delinquencies, defaults and foreclosures are not as high as pre-pandemic rates. However, the bleak economic uncertainty for the beginning of 2023 has caught the eye of experienced lenders who know how quickly things can change and how important it is to mitigate risk.

The challenge for lenders and servicers is twofold: **How do you effectively manage forbearance requests, delinquencies and defaults? And how do you accurately monitor portfolio risk and asset quality?**

Actively Monitor Risk

Interagency Appraisal and Evaluation Guidelines around prudent portfolio monitoring suggest understanding the collateral value, lien priority and combined loan-to-value ratios (CLTV) on the collateral, as well as deterioration of credit since origination or changes in market conditions.

Although most — if not all lenders — routinely monitor collateral values at regular intervals, given current market and economic conditions, it may be pragmatic to increase the frequency of monitoring to identify troubled assets sooner than later. A valuation cascade consisting of cost-effective Automated Valuation Models (AVMs), evaluations and desktop appraisals deployed based on collateral risk to proactively work with borrowers to mitigate default can be highly effective in managing portfolio risk.

There are a wide variety of valuation products available in the marketplace and leveraging these tools in a valuation cascade can reduce cost and improve visibility into a lender's portfolio.

Assess Collateral Valuations

To reduce expense, minimize default activity and provide a better borrower experience, Accurate Group recommends a valuation cascade commensurate with the stage of default. For example, in the early stages, the default or servicing manager may opt for a low-cost AVM vs. a more expensive valuation product. As the asset moves through the various stages of default, the valuation cascade would trigger the next valuation product determined by your credit risk guidelines.

The most effective valuation cascades begin with the least expensive valuation product and increase in cost and accuracy as you progress through the cascade. The industry is trending toward the utilization of desktop appraisals as a replacement for the commonly used Broker Price Opinion (BPO). This transition significantly improves valuation accuracy and creates operational efficiency and reduces the expense of having to reconcile multiple BPOs. Clearly understanding the value of the collateral is an essential component in every servicing and default process and ultimately guides management in their decision-making process.

Assess Lien Position, CLTV and Tax Delinquencies Using Title Data and Title Search Cascade

Similar to valuation cascades, title data should also be incorporated in a cascade at each stage of the default cycle. To reduce cost, Accurate Group recommends the use of batch title data to verify whether the lien is secured in the proper position and that tax payments are current. Batch title data used in conjunction with a valuation cascade can also help to refresh changes to loan to value or combined loan to value if there are multiple liens on the collateral.

If batch title data is not available or if the loan is headed down the path of default and eventual foreclosure when permissible, a full title search can be used to verify the status of the title, determine whether foreclosure is economically feasible or to prepare foreclosure documentation.

Partnering with a vendor that can supply multiple stand-alone valuation and title products or cascades can create much-needed visibility across servicing, default and foreclosure departments. Additionally, by combining the valuation and/or title cascade on one platform, various team members can compare and reconcile values throughout the process as needed, ultimately leading to better decisions.

Leveraging Data and Technology

By using technology that incorporates data from across the lender decision tree, you can streamline complex workflows, reduce workloads and cut operating expenses to make more informed decisions related to collateral risk. Certainly, uniting the breadth of valuation products — AVMs, evaluations, desktop appraisals and traditional appraisals — gives lenders a cheaper and quicker way to accurately assess portfolio risk.

For example, a borrower may qualify for a loan modification, but conducting the interior inspection of the home needed to develop a valuation may not be possible. Desktop appraisals, which were largely sought-after technology during the pandemic, are now the cornerstone of many lending businesses.

Directed Remote Data Collection (DRDC) uses video technology managed by an experienced data collector to direct the homeowner through a detailed interior and exterior inspection of their property. An appraiser or evaluator can rely on this data to develop an accurate desktop appraisal or valuation.

Rather than needing to walk into a brick-and-mortar lending business, borrowers can sign documents virtually.

While adoption of industry-leading e-signing and e-notary solutions like Accurate eSign and NotaryWorks™, which handles more than 90 million transactions a year, some lenders still rely on physical signatures and a traditional notarial process. Origination and servicing organizations can combine remote data collection with a remote online notary closing, allowing their borrower to never leave their home.

Electronic and remote technologies have proven to be a cost-effective way to expedite the loan process without compromising quality.

What Can Lenders Do?

Our world has fundamentally changed. Collateral risk is out there, and consumers are relying on their lenders for help. As an industry, we need to meet these challenges head on.

In the near term, a prudent collateral risk strategy may require that you:

- Immediately re-evaluate your portfolio monitoring process in terms of effectiveness and cost efficiency and consider a risk-based valuation cascade.
- Mitigate risk by leveraging data and technology in your servicing, default and portfolio monitoring processes.
- Evaluate your current vendor relationships to determine if you are receiving value and prepared for the road ahead.

For more information about Accurate Group solutions to help you prepare for and more successfully manage the mortgage challenges facing your organization today, visit http://www.accurategroup.com/solutions/servicers/.

About Accurate Group

Accurate Group is a real estate technology and services leader delivering technology-driven property appraisal, title data, analytics and digital closing solutions to banks, credit unions, servicers, non-banks and capital market firms. By combining modern process automation, accurate data and innovative SaaS and mobile technologies, Accurate Group provides its clients with the best combination of speed, quality, regulatory compliance and price.

With Accurate Group, the real estate finance community and consumers benefit from market-leading solutions that enable modern digital frameworks, improve accuracy, lower costs and improve compliance across all types of real estate loans, mortgage-related assets and real estate portfolios.

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