
July 30, 2009

Lucrative Fees May Deter Efforts to Alter Loans

By PETER S. GOODMAN

This week, the Obama administration summoned mortgage company executives to Washington to demand they move faster to lower payments for homeowners sliding toward foreclosure. Treasury officials called on the companies to hire and train more people quickly to field applications for relief.

But industry insiders and legal experts say the limited capacity of mortgage companies is not the primary factor impeding the government's \$75 billion program to prevent foreclosures. Instead, it is that many mortgage companies are reluctant to give strapped homeowners a break because the companies collect lucrative fees on delinquent loans.

Even when borrowers stop paying, mortgage companies that service the loans collect fees out of the proceeds when homes are ultimately sold in foreclosure. So the longer borrowers remain delinquent, the greater the opportunities for these mortgage companies to extract revenue — fees for insurance, appraisals, title searches and legal services.

“It frustrates me when I see the government looking to the servicer for the solution, because it will never ever happen,” said Margery Golant, a Florida lawyer who defends homeowners against foreclosure and who worked in the law department of a major mortgage company, Ocwen Financial. “I don’t think they’re motivated to do modifications at all. They keep hitting the loan all the way through for junk fees. It’s a license to do whatever they want.”

Rich Miller, a governance project manager at Countrywide Financial and Bank of America before he left in January, said Bank of America had been reluctant to modify loans, which hurt the bottom line. The company has been waiting and hoping the economy will improve and delinquent customers will resume making payments, he said.

“That’s the short-term strategy,” said Mr. Miller, who oversaw training programs at Countrywide, which was bought by Bank of America. He now works as an industry consultant.

Bank of America disputed that characterization. “To think that somehow or other we would jeopardize investor relationships and customer relationships for the very small incremental income we would receive by delaying seems ludicrous,” said Robert V. James, the bank’s senior vice president for mortgage operations and insurance. “It’s not the right thing to do.”

Mortgage companies, some of which are affiliated with the nation’s largest banks, are paid to manage pools of loans owned by investors. The companies typically collect a percentage of the value of the loans they service. They extract their share regardless of whether borrowers are current on their payments. Indeed, their percentage often increases on delinquent loans.

Legal experts say the opportunities for additional revenue in delinquency are considerable, confronting mortgage companies with a conflict between their own financial interest in collecting fees and their responsibility to recoup money for investors who own most mortgages.

“The rules by which servicers are reimbursed for expenses may provide a perverse incentive to foreclose rather than modify,” concluded a recent paper published by the Federal Reserve Bank of Boston.

Under the Obama administration’s foreclosure program, a servicer that modifies a loan for a homeowner collects \$1,000 from the government, followed by \$1,000 a year for each of the next three years. A senior Treasury adviser, Seth Wheeler, said these payments amounted to “meaningful incentives to servicers to help overcome the challenges and competing demands they face in considering and completing loan modifications.” He added that mortgage companies “are contractually obligated to the terms of this program, which require them to offer modifications to qualified borrowers.”

But experts say the administration’s incentives are often outweighed by the benefits of collecting fees from delinquency, and then more fees through the sale of homes in foreclosure.

“If they do a loan modification, they get a few shekels from the government,” said David Dickey, who led a mortgage sales team at Countrywide and Bank of America, leaving in March to start his own mortgage advisory firm, National Home Loan Advocates. By contrast, he said, the road to foreclosure is lined

with fees, especially if it is prolonged. “There’s all sorts of things behind the scenes,” he said.

When borrowers fall behind, mortgage companies typically collect late fees reaching 6 percent of the monthly payments.

“For many subprime servicers, late fees alone constitute a significant fraction of their total income and profit,” said Diane E. Thompson, a lawyer for the National Consumer Law Center, in testimony to the Senate Banking Committee this month. “Servicers thus have an incentive to push homeowners into late payments and keep them there: if the loan pays late, the servicer is more likely to profit.”

She cited Ocwen Financial, which reported that nearly 12 percent of its income in 2007 came from fees to borrowers.

Paul A. Koches, Ocwen’s general counsel, said: “We’d prefer that to be zero. The costs associated with our delinquent loans are in every instance in excess of the late fees.”

Data on delinquencies reinforces the notion that servicers are inclined to let problem loans float in purgatory — neither taking control of houses and selling them, nor modifying loans to give homeowners a break.

From June 2008 to June 2009, the number of American mortgages that were 90 days or more delinquent soared from 1.8 million to nearly 3 million, according to the realty research company First American Core Logic. During that period, the number of loans that resulted in the bank taking ownership of the home declined to 245,000, from 333,000.

As a home slides toward foreclosure, mortgage companies pay for many services required to take control of the property and resell it. They typically funnel orders for title searches, insurance policies, appraisals and legal filings to companies they own or share revenue with.

Ocwen established its own title company, Premium Title Services, in part to keep more of the revenue from foreclosures, said Ms. Golant, who helped start it.

“It was hugely profitable,” she said. “Premium Title would charge for the title when it got transferred to Ocwen, then charge again when it got transferred to the new buyer, and then sell title insurance. It was easy money.”

Mortgage companies not only gain this extra business through their subsidiaries, but also collect reimbursement for the payments when the houses are sold.

The investors who own bad mortgages accept whatever is left. Investors typically do not notice how much they give up to the servicers, because fees are embedded in complex sales.

“It’s under the radar,” Ms. Golant said.

Ultimately, the benefits of delinquency erode incentives for mortgage companies to dispose of troubled loans quickly, say experts, allowing distressed houses to decay and fall in value — a fact of little interest to the servicer.

“At the end of the day, it doesn’t matter what the house sells for, because they don’t take that loss,” said Ms. Golant. “Meanwhile, they are collecting all these fees.”