Contact:

Mark Smith
PReturn, Inc.
312-371-6443
msmith@preturn.com

Steve Nunley
AnswerMine Group, LLC
847-332-2500
snunley@answerminegroup.com

Issue Backgrounder

Proper Targeting of Loan Modifications Can Reduce Re-defaults for Mortgage Lenders

Analyzing borrowers' credit variables is key to successful modification strategies

Evanston, Ill., October 20 – Mortgage modifications have become a necessary survival tactic for banks struggling to reduce losses in a mortgage market wracked by defaults and foreclosures.

Within legal, accounting and regulatory restraints, lenders are implementing modifications even while they wrestle with the question of what circumstances lead to a successful modification.

Waiting until a loan is 60 to 90 days in default usually proves less successful, as evidenced by high re-default rates. On the other hand, modifying loans before they default produces better results by reducing the losses caused by re-defaults – a key metric for lenders. For example, in its MBS Strategy report issued October 2, 2009, J. P. Morgan Securities finds re-default rates of 60 to 70 percent among borrowers whose mortgages were modified after they missed two or three payments, while only 2 to 30 percent of borrowers who were current at the time of modification defaulted within 12 months of restructuring. (See Footnote #1.)

To successfully walk the line between too-generous and too-restrictive modification policies, lenders need analytic models that target troubled borrowers who are most likely to benefit from early restructuring.

New models, such as those from AnswerMine Group, examine an extensive range of variables describing credit behavior of individual borrowers, mortgage data and macroeconomic information to specifically predict borrowers' mortgage-payment performance.

"FICO scores are still useful to a degree, but banks need more focused and sophisticated analytics to predict a borrower's ability and willingness to pay their mortgage obligation. Using granular credit data in conjunction with mortgage and macroeconomic variables allows our proprietary models to capture higher order interactions that are more predictive of mortgage payment behavior," said Steve Nunley, practice director at AnswerMine Group. "Our analysis paints a more reliable picture of the borrower's true financial condition which leads to more successful modifications."

For both performing and non-performing loans, sophisticated analytics can predict how likely the borrower is to make good on a restructure.

“With banks swamped by defaults, our targeting analytics can identify which ones to address first, assigning a priority to every loan – performing or not – based on its likelihood of re-default,” Nunley explained. “By understanding which loans have the greatest probability of success, a lender or servicer can fine-tune its strategy to yield the highest success rate for their efforts.”

The need to maximize a portfolio’s net present value (NPV) drives a lender’s or servicer’s willingness to restructure mortgage loans. Although the emphasis appears to be on surviving the current crisis by minimizing losses, banks increasingly understand the positive impact of loan modifications on their long-term survival and success.

“Capital preservation is ultimately what keeps the banks in business,” said Ed Buchanan, practice director at AnswerMine Group. “Actions taken today to reduce losses will help banks conserve capital needed for long-term survival.”

Mortgages look like cash-flow loans

Historically, mortgages were collateralized by the value of the real estate. As home equity continues shrinking for most borrowers, mortgages have taken on many of the characteristics of unsecured cash-flow loans.

“Banks have to look at mortgage borrowers based on their credit behavior,” Buchanan noted. “If you can look at the data and determine that the borrower is viable going forward, you can see the value in taking 80 or 90 cents on the dollar in a loan modification rather than pursuing foreclosure. But you have to have faith in the analytics and make sure the model is sophisticated and robust.

“Sometimes the analytics will tell you that the borrower has no chance of success, even with a modification.”

Buchanan and Nunley agreed that insufficient capital and inadequate operational capacity to take remedial action are leading causes of bank failures. “We provide both the analytics, through our models, and the operational resources, through call-center outsourcing, to help banks realize the benefits of targeted restructuring. Right now, it’s all about surviving and positioning for future success,” Buchanan said.

About AnswerMine Group

AnswerMine Group builds forecasting and segmentation models for successful application across many industry segments. Using propriety analytic software, AnswerMine has refined and perfected the theory and method of data analysis into an accurate, fast and flexible practice.

AnswerMine Group employs a philosophy to “let the data speak.” Its technology analyzes large datasets for profiles that link outcomes of interest with combinations of characteristics that can be used in predictive and segmentation models.

In addition to methodological expertise, AnswerMine’s professionals have extensive experience in and knowledge of the industries the company serves. Its staff

pioneered the use of Information Gain Theory and decision trees in many areas of business.

For more information, please visit www.AnswerMineGroup.com.

# # # # #

Footnote #1:
Recidivism rates show no sign of stabilizing for delinquent borrowers (MBS Strategy, US Fixed Income Strategy, J.P. Morgan Securities Inc., page 14, October 2, 2009). At 12 months past modification, borrowers who missed two or more payments, have re-default rates that range from 60 to 70 percent regardless of product type. For borrowers who were current at the time of modification recidivism rates range from 2 to 30 percent depending on the product.