SERVICING MANAGEMENT®

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Be Certain To Pass Files Prior To Foreclosure Sale Dates

There are a number of benefits associated with tackling the REO process as early as possible.

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There are some critical factors to be considered when servicing a real estate owned (REO) property. This holds true whether the servicing is done by an internal REO department or an outside party. Protocol cannot be written for every scenario that arises, and the ability to trust the instincts of your asset manager or vendor partner is crucial.

It is particularly surprising that many lenders wait to involve their REO personnel until after the foreclosure sale. Waiting to initiate the REO process leads to a potential decrease in the property value and other unwanted scenarios. Consider that delays in initiating field management work increase the likelihood of deterioration and vandalism. It also lengthens the time to market the property, which adds to lenders' holding costs.

To address this challenge, it is recommended that lenders assign the asset to REO specialists prior to the foreclosure sale. Making sure that you have a watchful eye on the property while in the pre-foreclosure stage is of utmost importance. By obtaining occupancy information and market values as the foreclosure date approaches, you can more effectively establish foreclosure sale bids.

By initiating the REO process when the sale date is scheduled - or at some other pre-foreclosure point - and engaging the broker handling the management and disposition, one can achieve three key improvements. First, an improved valuation can be achieved on vacant properties by having the broker perform an interior broker price opinion (BPO). A substantial factor in the loss severity deals with the surprise factor inherent in using drive-by BPOs for foreclosure sale bids. We have all seen a house that looks acceptable from the street, but soon discovered that a nightmare awaited within.

> *All involved parties can hit the ground running upon completion of the foreclosure process.*

A second benefit to earlier involvement pertains to securing and preserving the asset. A property's condition will not improve when it is left alone. Rather, it will almost invariably deteriorate. Whether the property is located in a high-crime area where theft of systems and appliances is common or in an area that serves as the hangout spot for neighborhood kids, REOs tend to decline in condition and value when unsecured and unmanaged. Simply put, earlier involvement preserves value.

A third key benefit deals with the initial timeline in the REO life cycle. Time is money: The sooner a property is ready for market, the sooner it can sell. By initiating the asset manager or REO vendor prior to foreclosure, all involved parties can hit the ground running upon completion of the foreclosure process. The broker can complete the BPO, plan for trash-out and lawn maintenance, and pre-market the REO earlier in the process.

To maximize the benefits of outsourcing, lenders should give vendors the responsibility of obtaining valuation products, auditing them and recommending market and list price values. Many lenders don't have any logical methodology for establishing market and list price values. Very often, market values are established by taking the average of all BPOs or appraisals obtained, and adding some arbitrary spread over the average to generate a list price. The involvement of trained valuation personnel boosts quality control and helps minimize problems relating to incorrect

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market and list price values.

As volume dictates, either the vendor or the servicer can establish a valuation desk or department. Some servicers hire staff appraisers to review the valuations, while others have the vendor perform the function - subject to their final review and approval.

To illustrate this, an audit of more than 2,000 closings for the REO department of a national lending institution assessed the accuracy of appraisals by comparing the values to the ultimate REO sales price. Appraisal values were within 10% of the REO sales price just 32% of the time.

The reasons for this included the use of retail (non-REO) comparables. Using such comparables results in the need for greater condition adjustments to determine value and, therefore, it is more prone to error.

Another issue is the rehabilitation factor. While an appraiser may accurately calculate the cost to rehabilitate, he often does not factor that the buyer needs to have a spread or return on the rehabilitation funds. Otherwise, the buyer would choose to buy a property in good condition and avoid the cost and time of the rehabilitation process.

There is also validity in how buyers perceive an REO property, and appraisals can overlook this factor. Appraisals rely heavily on facts and figures to establish a value. BPOs do the same, but they also take the "emotions" of a buyer regarding the property's condition into consideration.

The need for accurate REO valuation continues during REO marketing. Once the property is listed for an initial period of 30 to 45 days maximum without a contract or the desired activity, the asset manager or vendor needs to have dialogue with the REO broker relative to market conditions and value. Is it the broker's opinion that the property is priced too high? Have similar properties sold or gone under contract? Having such conversations, along with obtaining a new BPO, is critical. And just as with the initial valuation, trained eyes should review the BPO and supporting information to determine what adjustments are required.

Benchmark performance

Establishing and utilizing a method for tracking REO servicing performance is important in both internal and outsourced REO servicing operations. It is critical to establish benchmarks on which performance can be judged.

The life cycle of an REO asset has seven main stages:

■ Pre-foreclosure. The foreclosure sale has been scheduled.

■ Acquisition. The sale has occurred, and the lender was the high bidder.

■ Possession. The foreclosure sale has been confirmed, and the REO property is vacant.

■ Eviction. The foreclosure sale has been confirmed, and eviction is initiated on occupants and personal property.

■ Listing. The REO property is offered for sale.

■ Pending. An offer has been accepted, and a contract has been signed by both the buyer and seller.

■ Closed. Title to the property has been conveyed, and the purchase has been funded.

Each of the seven stages has a specific timeline range that is commonly accepted in the industry, although some variance can and does exist between counties.

The timelines are as follows:

■ Pre-foreclosure. Thirty days from the foreclosure to the scheduled sale date - varies by jurisdiction.

■ Acquisition. Fourteen days from the date of the foreclosure sale to confirmation of the sale.

■ Possession. Two to three days is standard, from sale confirmation to a secured property, unless an eviction is required.

■ Eviction. As few as 21 days - varies by jurisdiction.

■ Listing. Sixty to 90 days.

■ Pending. Thirty to 45 days, depending on the type of financing and the jurisdiction.

■ Closed. One day.

The total timeline range from the scheduling of the foreclosure sale to a closed REO property is 137 to 204 days. Tracking the timelines of each stage has two benefits. Used as an asset management tool, it ensures that an REO property is proceeding in an efficient manner, or highlights the area of delay. Exception management policies that address causes of delays are becoming more widely used. The second benefit is that the timelines become a way in which to judge performance.

The volume of mortgage default and REO is expected to climb in 2006, and incorporating these practices will be rewarded with important time and cost savings in your REO process. SM