Negotiating with the Mortgage Company by Katie Porter

At the heart of a loan modification is communication between a creditor and a debtor that leads to an agreement on new contract terms. If the debtor cannot get reach a person with authority to negotiate, a modification won't be possible. If the creditor can't get the debtor to return its calls or read its mail, a modification also won't be possible. The communication problems in todays securitized mortgage market are very different than during past real estate downturns, such as the Midwest farm crisis of the 1980s or the wave of foreclosures in the 1930s. Why? Because of the widespread use of mortgage servicers, third-party agents who collect payments from borrowers and remit them to the mortgage note holders (usually investors, often via a trust).

Mortgage servicers are responsible for enforcing defaults, including pursuing foreclosures, and for engaging in loss mitigation. Gone are the days of sitting down with the bank that originated your loan and negotiating a new deal. Why am I making this very basic point? Because I am concerned that policymakers, including legislators, judges, and regulators still do not understand the barrier that loan servicing presents to voluntary or consensual loan modification.

I keep seeing reference to the willingness of "lenders" to negotiate, but the reality is that it is a diffuse group of investors (including people like me whose 401(k) plans bought securities backed by mortgage receivables), not lenders who own the note. And the investors contracted with mortgage servicers via pooling and servicing agreements to service the loans. Thou terms of those contracts may limit servicers' freedom to negotiate or offer loan modification. Perhaps the bigger problem though is that mortgage servicers actually PROFIT from default. To be clear, I wrote servicers, not investors, who do face large losses when foreclosures occur. How can servicers profit when a borrower defaults? Because servicers typically retain fees, such as late fees, that are paid by consumers. Servicers may also assess other default charges such as property inspections or attorney’s fees when a loan goes into default.

Allegations are swirling around that servicers up-charge for these default costs, tacking on profit to the actual charges they paid for the servicers when they bill the consumer. Even if this isn't happening, simple late fees are a huge source of revenue for mortgage servicers--millions of dollars each quarter. The flip side is, that while default can be profitable for servicers, modifications are very costly. The available estimates suggest that loan modifications cost $500-$1000. What incentive do servicers have to spend this money? The answer to this question may change with new legislation introduced by Representative Waters.