White Paper

The Power of Integrated Claims & Conveyance Services

Dramatically reducing operating expenses and penalty risks of FHA and other Investor-Backed Loans through integrated processing.

Written by: Denis Brosnan, Valerie Elkins, & Eskinder Assefa

White Paper

How integrated processing of insurance claims and conveyance-related servicing activities dramatically cut operating expenses and mitigate penalty risks on FHA and other investor-backed loans.

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Executive Summary

While mortgage delinquency rates are at a record low of 1.24% of all mortgages, Servicers continue to face a number of challenges that keep costs high, placing downward pressure on profits.

Servicers typically have to allocate as much as a third of their resources to process Non Performing Loans (NPLs), although they make up only 2-3% of all the loans serviced. This makes NPLS roughly 13 times as expensive to process as Performing Loans (PLs).

Until Servicers find ways to control costs of NPLs, their businesses will likely continue to generate low profit margins.

THE PARTICULAR CHALLENGES OF FHA NPLS

Federal Housing Administration (FHA) NPLs are particularly expensive to process. The Mortgage Bankers Association (MBA) estimates that the non-reimbursable costs and direct expenses associated with FHA's foreclosure and conveyance policies were **two to five times higher** than for Government Sponsored Enterprise (GSE) loans.

According to the FHA's Single Family Loan Performance Trend Report, it takes an average of 12 months to convey a foreclosed property to the FHA. Furthermore, nearly **43%** of the 2015 and 2016 FHA insurance claims filed received an interest curtailment penalty because of missed first legal action deadline (29%) or reasonable diligence deadline (14%).

CURRENT APPROACHES DON'T MAKE SENSE

The Servicer's business is optimized to process large volumes of performing loans. It is not optimized for managing the many and varied processes necessary to bring a foreclosed property to conveyance. This becomes especially difficult and expensive with FHA foreclosed loans.

MBA's analyses show that nearly a third of a Servicer's resources are allocated to processing less than 3% of its overall loans.

To put it another way, a Servicer has to allocate **over sixteen times** as many resources on NPLs as it does on PLs.

Clearly, the current approach is very inefficient and costly.

THERE IS A BETTER WAY

A better alternative is to simply **refer** a foreclosed property to a single vendor who can perform multiple claims and conveyance-related processes at the same time, thereby significantly cutting the cost and time to conveyance.

This paper discusses this new, innovative approach in detail by first outlining the key trends that affect Servicers and how these can drive the costs of NPLs, especially FHA foreclosed loans. The paper then discusses how integrated processing of claims and conveyance-related servicing activities will dramatically cut operating expenses and mitigate penalty risks on FHA loans and other investor backed loans.

Finally, this paper shows how DIMONT's **Collateral Loss Mitigation Service**, an end-to-end conveyance management platform, can significantly cut the time to conveyance, thereby reducing the total cost of conveyance on average by at least $500 per foreclosed loan.

Trends in The Mortgage Servicing Industry

Although the Mortgage Servicing Industry is generally profitable, it increasingly faces adverse threats that collectively tend to raise costs and risks, and thereby reduce profitability. Below are some of the more important factors that can significantly affect a Servicer's profitability.

Origination Volumes

According to the Mortgage Bankers Association (MBA), while purchase originations are expected to increase in 2018 from 2017 levels, the overall total number of originations is expected to be lower due to a 28.3% drop in refinance origination. Overall, the MBA forecasts 2018 mortgage originations to decrease to $1.597 trillion in 2018 from $1.688 trillion in 2017.

While default rates are declining, without some increase in volumes profitability will be adversely impacted, as fixed operating costs will remain high across portfolios that are not being refreshed by new originations.

Delinquency Rates

Per the Federal Reserve Bank of New York, the number of delinquent loans (defined by the bank as loans with payments 60 days past due) has declined to 1.24% of all mortgages. Delinquency rates are believed to be declining due to the currently strong economy, low unemployment rate, increased tax refunds and bonuses, and home price appreciation.

On the other hand, by the end of 2017, the average mortgage debt for borrowers had increased to $201,736 – up more than $7,000 from 2016[1]. For 2019, TransUnion expects that mortgage performance will continue to improve, leading to record low delinquency rates – even below the lowest level seen in 2005[2]. As a result, Servicers stand to lose late charges and other default-relate revenue streams.

Severe Weather Patterns

Mortgage delinquencies did begin to creep up again in the fall of 2017, but for reasons unrelated to loan performance, notably the string of massive storms that hit the Eastern and Southeastern Coastal areas. The fallout especially from Hurricane's Harvey, Irma, and Maria has pushed up the number of delinquencies.

According to the American Meteorological Society, models project a **45 to 87% increase** in the frequency of Category 4 and 5 hurricanes.

National Mortgage News reported that some seven million coastal homes face more than $1.6 trillion in potential storm related construction expenses in 2018. This is a 6.6% increase in costs from 2017. Investors hold Servicers responsible for ensuring collateral is repaired after the storms, increasing staffing costs and third-party expenses.

Servicing Costs

Servicing costs for **performing loans** reached their peak in 2015, with the average cost for servicing a single-family loan reaching $181 per loan – the highest cost since the 2008 recession. 2016 saw the first drop in costs to service performing loans since 2008. The cost to service performing loans declined to $163. According to the MBA the main reason for costs coming down was a marked decrease in overhead costs.

The cost to service **non-performing loans** has also decreased. In 2016, the average cost to service a non-performing loan was $2,113 – a $273 drop from the servicing costs in 2015.

Unlike the reason for performing loan cost decreases, the primary cause for declining service costs for non-performing loans is a marked decrease in the number of seriously delinquent loans[3]. As of September 2017,

[1] Calculated Risk: MBA: Mortgage Delinquency Rate decreased in Q1. http://www.calculatedriskblog.com/2018/05/mba-mortgage-delinquency-rate-decreased.html

[2] Corelogic: Mortgage Delinquency Rate Fell from a Year Ago, Now Close to the Pre-Crisis Level. https://www.corelogic.com/blog/2018/05/mortgage-delinquency-rate-fell-from-a-year-ago-now-close-to-the-pre-crisis-level.aspx

[3] MBA Chart of the Week: Servicing Costs Per Loan (Single-Family) – Performing v. Non-Performing. https://www.mba.org/servicing-newslink/2017/july/servicing-newslink-tuesday-7-25-17/news-and-trends/mba-chart-of-the-week-servicing-costs-per-loan-(single-family)-performing-v-non-performing

the rate of seriously delinquent loans is 1.9% - a 0.4% drop from September 2016. This rate marks the lowest level of seriously delinquent loans since October 2007[4].

Despite the downward cost trend for non-performing loans, these servicing costs are still significantly higher than those associated with performing loans. In general, servicing costs are not expected to come down much further due to high compliance related costs.

Servicing costs of non-performing loans are significantly higher because they include all the costs associated with performing loans, with the additional costs of collections, loss mitigation, foreclosure, post-sale, bankruptcy, unreimbursed foreclosure expenses, real estate owned losses, and other default-specific costs.

These costs are driving many firms, especially depository institutions, out of the Servicing business. Subservicing has become one way of filling the servicing void. The unpaid principal balance of servicing that is subserviced has more than doubled to over $2 trillion from $900 billion in 2013.

Legal and Reputational Risks

Servicers are governed by regulations and contracts that can pose significant legal and compliance risks. There are many federal and state agencies that regulate mortgage servicing standards, as do the GSEs. Private investors also have their own requirements and standards to be met.

Any errors by Servicers as they service a broad array of loans can result in fines or even lawsuits. GSEs or Ginnie Mae can confiscate the servicing, forcing a charge off on the value of the MSA.

Furthermore, negative publicity can lead to reputational harm and can result in loss of business. The negative reputation on the servicing side can spill over to dampen the origination business as borrowers avoid a bank that is receiving negative publicity in the media.

Impact of the Tightening Labor Market

Tighter labor markets favor employees to the disadvantage of employers. Finding new employees means having to pay more in a competitive labor market. Furthermore, tighter labor markets encourage upward mobility as employees seek better paying jobs, thereby increasing turnover rates. Recruiting, training and terminations costs go up, driving down the returns on payroll and related expenses.

Taken together, these factors tend to significantly increase the relative cost of labor-intensive operations. The conveyance of foreclosed FHA loans is especially time consuming and costly.

Servicers can expect their cost of servicing their non-performing loans to increase as competition for labor increases.

Servicers face significant challenges as they try to manage their risks and work towards attaining sustained profitability. Many of these challenges are outside the direct control of Servicers. These trends generally affect the overall business of the Servicer, impacting both the performing and non-performing loans it manages.

In the next section, we specifically focus on non-performing loans. We look at the difference in cost structure between performing and non-performing loans and the specific risks and costs associated with FHA loans when they go into foreclosure.

[4] Housing Wire: Serious Mortgage Delinquency Rate Hits Lowest Point in Decade. https://www.housingwire.com/articles/42071-serious-mortgage-delinquency-rate-hits-lowest-point-in-a-decade

The High Cost of Managing Non-Performing Loans

Historically, the cost of processing non-performing loans (NPLs) has always been significantly higher than for processing performing loans (PLs). From their lowest point in 2008 when processing NPLs was about eight times as expensive as PLs, they have steadily increased to cost almost 18 times as much in 2012 before coming down again.

While costs for both PL and NPLs have come down since their peak in 2015, both are significantly higher than their pre-Great Depression levels: performing loans were **176% higher** in 2016 compared to 2008 rates and non-performing loans were **338% higher** in 2016 than in 2008.

It is important to note that, while it is possible to partially contain the cost of processing PLs through automation, processing NPLs is a different matter, as we shall see below.

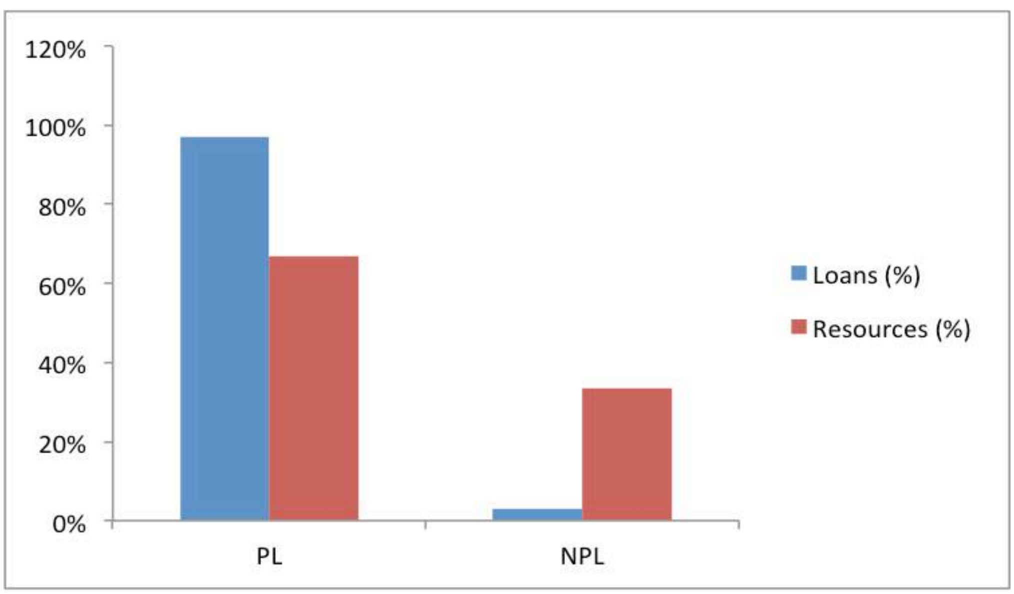
A Very Different Business Model

The Servicing business model is a high-volume play where Servicers charge a very small fee per transaction and rely on the size of their servicing portfolio to produce both revenue and profits. Because of both the high volume and low per unit fee and because margins for errors are small, the servicing business must be optimized and standardized for automation to remove labor costs, improve quality, and reduce costly errors. It is a business model that relies on economy of scale.

However, this completely flips when loans become non-performing, turning a mostly automated process to one that is mostly labor-intensive.

As the chart below shows, roughly 33% of a Servicer's resources would be allocated to processing non-performing loans, which make up less than 3% of all loans. It is clearly highly inefficient and costly for a Servicer to process NPLs.

Comparing resource allocations for Performing Loans (PLs) and Non performing Loans (NPSs)



The Specific Challenges of Foreclosed FHA Loans

Non-performing Federal Housing Administration (FHA) loans are particularly expensive to process. The MBA estimates that the non-reimbursable costs and direct expenses associated with FHA's foreclosure and conveyance policies were two to five times higher than for GSE loans, even before the GSEs changed their compensatory fee schedule. The two biggest drivers of high FHA servicing costs are:

- An inflexible foreclosure timeline and draconian penalty system
- A complex property conveyance process that slows down resolution, causing properties to remain vacant longer, which can increase maintenance and repair costs.

FHA Requirements are Labor-Intensive

To bring the property to conveyance condition, Servicers must inspect the property, get a repair estimate, obtain approval from the FHA when costs exceed allowances, and complete all necessary repairs.

For most Servicers, this requires coordination between FHA staff and several third-party vendors such as title companies, inspection companies, and repair crews.

Furthermore, the FHA requirements force the process to be time consuming and repetitive. While the FHA imposes these requirements to reduce the need for further repairs after conveyance, the 30-day conveyance timeframe is fairly tight and liable to be missed. Servicers that miss this timeline will be penalized with **curtailment of debenture interest** and **property preservation expenses** that would otherwise be due to them.

FHA Conveyance is Time Consuming

According to the FHA's Single Family Loan Performance Trend Report, it takes an average of 12 months to convey a foreclosed property to the FHA, instead of the 30 days designated by the rule.

According to an analysis by the Mortgage Servicing Collaborative (MSC), FHA conveyance took about 928 days from last paid installment to conveyance, while non-conveyance options took an average of 585 days. The conveyance alone added nearly a year (343 days) to the process.

Furthermore, the longer the property remains vacant, the higher the likelihood the property will be damaged, vandalized, or affected by severe weather, requiring additional repairs and increasing property preservation expenses—which are mainly incurred by the Servicer.

FHA Conveyance Penalties Are High

Analyses by the Mortgage Servicing Collaborative (MSC) shows that nearly **43%** of the 2015 and 2016 FHA insurance claims filed received an interest curtailment penalty because of missed first legal action (29%) deadline or reasonable diligence deadline (14%).

The average per loan property preservation cost for FHA properties that were conveyed is **$8,819** compared with $2,113 for non-conveyance options taken (source: MSC servicer data).

The table below shows the stark differences between the two timelines and associated costs (Source: MSC member data).

	Conveyance	Non - conveyance
Shares of all liquidations	53%	47%
Days from last installment to resolution	928	585
Property preservation costs	$8,819	$2,133
Property preservation losses	$4,179	$706
Other losses such as foreclosure fillings, legal fees, etc.	$3,508	$3,450

The Right Way to Manage FHA Foreclosed Loans

Why Current Approaches Don't Make Sense

Presently, most Servicers follow a multi-vendor process to bring a property to conveyance:

- Servicer refers action to a Property Preservation Vendor (PPV)
- Servicer refers action to an Investor Claims vendor (IC)
- The PPV sends damage report to designated hazard insurance claims vendor
- Hazard claims vendor files the insurance claim and notifies the Servicer if repairs are needed Hazard claims vendor provides the settlement check to the Servicer
- Servicer requests the PPV to obtain bids and conduct repairs as necessary
- PPV notifies IC vendor of ICC and maintains property ICC
- IC vendor prepares and files the FHA Part A & B claims

The Servicer works with a Property Preservation Vendor as well as a Hazard Claim adjusters and Investor claim filers in multiple iterative steps.

Because multiple parties are involved, the process tends to evolve into a serial one. When one party completes its task, it notifies the Servicer, who then notifies the next party. However, that party may not have resources free to immediately take the next step, and may be delayed. This simply increases the likelihood that deadlines will be missed.

Due to penalties for missed deadlines as well as other costs, Servicers have to build in-house expertise in processing foreclosed loans so as to properly process what turns out to be a very small portion of their loans.

To Servicers, processing NPLs is a **cost center**. They build in-house expertise to avoid missing deadlines and properly file all claims in order to avoid penalties and re-conveyance expenses.

Furthermore, since Servicers want the proportion of NPLs to be as small as possible, **it does not make sense to build expertise** in an operation they actually hope will never be necessary.

The Right Way to Handle NPLs

The right way to manage the property conveyance process is to outsource it to a vendor for whom this process is a profit center. This vendor would have every incentive to make the process as efficient, risk free, and inexpensive as possible.

Such a vendor would process far more foreclosed FHA loans than any Servicer's in-house team would. Its significant economy of scale would enable it to invest in proprietary technology designed to reduce time, errors, and the specialized labor needed to perform the complex tasks in this arcane area.

Such a vendor would be optimally setup to carry out the multiple processes described earlier in parallel, rather than serially, thereby significantly reducing the total time to conveyance and the total cost.

Whenever missing deadlines is very costly—as is the case with foreclosed FHA loans—the ability to parallel-process tasks becomes a critically important capability.

A New Model for Handling NPLs

What if a Servicer could simply **refer** a foreclosed loan to a single vendor and receive back a compliantly conveyed property well within the deadline? From the Servicer's point of view, handling the conveyance process should be as simple as that.

Working with a single vendor such as DIMONT confers the following benefits to the Servicer:

1. A single point of contact for all responsibilities related to foreclosed loans through the completed conveyance providing a single report on all NPLs.
2. Significantly reduced time to conveyance (measured in weeks saved).
3. Significantly reduced cost of bringing foreclosed loans to conveyance (measured in hundreds of dollars savings per foreclosed loan).
4. Low service fee as a result of bundling of services and the use of integrated technologies and processes.
5. Significantly improved responsiveness, thereby building and maintaining the Servicers reputation.

It now becomes DIMONT'S responsibility to bring the property to conveyance on time.

The ROI of Integrated Collateral Loss Mitigation

With integrated loss resolution services, Servicers can expect to see **at least $500 in savings** per foreclosed loan. The details of our analysis follow.

Assuming an average servicing cost of $2,113 per non-performing loan (NPL) and an average of 343 days to bring a NPL to conveyance, we can estimate the average daily cost to be $8.10 per NPL. In other words, each day saved reduces the cost to the servicer by $8.10 per NPL.

DIMONT ran analyses over several thousand NPL files and found that it can typically shave off at least three weeks from the total time to achieve conveyance condition, thereby eliminating a minimum of $170.

More importantly, DIMONT found that its built-in quality assurance **dramatically reduces re-conveyance** of properties thereby eliminating costs that would not be reimbursed.

Our data analysis shows that reducing a Servicer's re-conveyance rate by just 5% would save at least $325 per foreclosed loan. If the reduction in re-conveyance is greater than 5%, as it can be in many cases, the savings will be greater than $325 per foreclosed loan.

Collateral Loss Mitigation Solution

What It Is

DIMONT's Collateral Loss Mitigation (CLM) Service is an end-to-end conveyance management platform that significantly cuts the time to conveyance, thereby reducing the total cost of conveyance on average by at least $500 per non-performing loan.

DIMONT's complete suite of CLM services handles all aspects of the hazard insurance and FHA claim recovery processes in parallel, thereby achieving conveyance faster, cheaper, and more securely than any alternative available to Servicers.

The compliance risk and technology challenges inherent in efficiently processing non-performing loans warrant an integrated solution rather than a disaggregated, best-of-breed approach.

How It Works

The purpose of CLM is to reduce the complex, multi-step conveyance process to a single step of referring the property to DIMONT.

DIMONT then prioritizes and performs all necessary tasks collaboratively to bring the foreclosed loan to conveyance faster and cheaper than the multi-vendor process that currently exists, including:

- **Bid/Repair Review** – review to make sure that all damages have been included in the claim and that all repairs are completed
- **Property Preservation QA** – Conduct Quality Check on 100% of inspection reports to ensure properties have been correctly identified as being In Conveyance Condition
- **Settlement Management** – Notify the client and preservation vendor immediately upon receipt of the insurance settlement information to enable prompt repairs
- **Conveyance Analysis** – Conduct portfolio analysis to provide recommendations on conveyance options
- **Conveyance Escalation** – use enhanced reporting to work with vendors in prioritizing and coordinating effort to resolve title and repair issues

DIMONT's intense focus on quality assurance enables clients to win maximum reimbursement allowed, while avoiding penalties and eliminating risk of re-conveyance.

Why It's Different

Currently, Servicers have to play the role of project manager and strive to build excellence in an area that makes up only a very small fraction of their business.

DIMONT's Collateral Loss Mitigation (CLM) service, however, enables Servicers to focus on their core business of managing performing loan and simply refer foreclosed loans to DIMONT.

This is essentially **a game changer** for Servicers, enabling them to free up a significant portion of their resources that are valiantly but inefficiently processing a very small fraction of their business, and re-allocating these resources to their core business.

About DIMONT

Founded in 1996, DIMONT is a leading provider of technology-enabled solutions in specialty insurance claims processing and collateral loss mitigation management for mortgage and auto lenders, servicers, and investors in the United States. Since 2010, the company has recovered over $2 billion in insurance claim proceeds for its clients.

DIMONT assists loan servicers and investors mitigate losses on collateral through a suite of value added technology-enabled services, including hazard claims filing, flood valuation audits, Loss drafts funds disbursement, and FHA/GSE/MI/VA/USDA claims processing.

As a SOC-1 certified vendor, DIMONT has long-standing relationships with four of the five largest mortgage lenders, as well as with the GSEs—a single source vendor for all insurance claim needs including:

- Hazard Claims – A licensed adjuster solution for filing hazard claims on lender placed and retail insurance policies, capturing maximum recovery dollars for the investor.
- Investor Claims – Mortgage loan investors and servicers rely upon DIMONT's expertise in collateral valuation and insurance recoveries for scalable, compliant solutions that reduce the risk of losses in the collateral liquidation process. We engage clients to analyze, design and execute specialty, outsourced solutions that minimize corporate advances; increase government, MI and GSE reimbursements; and reduce post-default resolution operating expenses.
- Flood Valuation audits – we perform in-depth structural analyses and issues valuation opinions of structures in flood zones conforming to the National Flood Insurance Program.
- Loss Drafts – Our insurance claims, inspection and repair expertise partnered with a collaboration portal provides an efficient collateral protection solution and self-service offering to the Mortgage Industry.

How to Reach Us

You may reach us in a number of ways as listed below:

Corporate Address	18451 N. Dallas Parkway Suite 200 Dallas, TX 75287
Phone	(972)-428-6900
Website	www.dimont.com
Sales	business.development@dimont.com