 By Kevin Coop

# A New Twist for the Servicing Marketplace

Servicers have always been very conscious of the value of collateral backing the mortgages they look after. While their first priority is keeping borrowers on track, it is also crucial to know that the collateral used is solidly valued, should any unexpected circumstances arise.

Although almost completely overshadowed by the success of the pre-meltdown marketplace, unexpected circumstances are commonplace today and have placed the servicer in the limelight of the entire industry as a potential savior of both borrower and property.

To meet modification and default levels of historic proportion, servicers are stepping up in a stellar way to ensure adequate understanding of the actual value of collateral in a very liquid marketplace. As home values continue to flip-flop across the country, it's no longer a foregone conclusion that collateral will always underpin the portfolio or the investor.

Adding to the trickiness, markets have segmented into microcosms—some successful and others, for no particular reason, not. Thus, value is not just a one-solution game anymore, but a flowing thing that can change direction seemingly overnight.

Speaking literally, the modifying of millions of loans is, in effect, a project of re-evaluating much of the work the industry accomplished in the latter years of the last decade. In that re-evaluation, all are taking a hard look at the tools and processes utilized.

As an industry, we are looking for solutions that will allow us to move forward while at the same time utilizing intelligence that will help highlight signs of potential issues and enable us to reduce or greatly mitigate unexpected circumstances. Simply put, is there a better way?

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### Valuation in the servicing shop

Of all the moving parts that make up a well-functioning home lending machine, the mortgage loan servicing shop is probably the most important. But until recently, it also was seemingly one of the most neglected in the industry. As the industry has worked tirelessly to provide those working in the front end of the business with every imaginable intelligence tool, the question might arise as to why the folks who quietly "watch the back" of the banking and residential mortgage-backed securities (RMBS) system don't seem to get an equal share of the budget.

In the industry's defense, there aren't bells and whistles going off when most loans are performing. So, a push for cutting-edge technology might fall under the "if it isn't broke, don't fix it" rule. However, any machine pushed to or past its limits is subject to failure. As the market has changed over the past few years, servicing has found itself in much the same boat as valuation—needing to make a mad dash to find and match modern tools to new issues.

Valuation plays varying roles in a servicing shop. Property value is monitored in performing portfolios to ensure that loan-to-value (LTV) ratios stay within acceptable ranges with adequate liquidity. Property value is again important when a borrower is in trouble—either to determine whether modification is an alternative or if disposition of the property is a better solution to an unfortunate situation. If it is determined that disposition is necessary, valuation plays an important role in multiple stages of the process ranging from setting the list price to monitoring the stability of the marketplace.

Historically, three types of valuation tools have been popular in the servicing arena:

- *Automated tools,* which are most commonly branded as automated valuation models (AVMs), use a database and algorithms to determine a property's worth. These high-speed, low-cost tools have evolved over the years and can now report on anticipated property value as well as statistical market conditions and risk factors that may impact value and/or marketability.

While extremely popular, most AVMs have an Achilles' heel in that all properties in the analysis are automatically considered average/typical/marketable examples. The problem is that because no property inspection whatsoever is performed, the value assigned may not reflect the actual worth of the property—especially if it is like those featured by host George Gray on his *What's With That House?* program on cable channel Home & Garden Television (HGTV).

- *Broker price opinions (BPOs)* ask a neighborhood Realtor® to place a value on a property. Realtors are experts in their markets and place list prices on property supported by closely neighboring comparable sales. Less detailed than appraisals but nevertheless effective, the BPO, which has been an industry workhorse, is coming under fire in several states as its defined use is to determine list price for sale rather than value. This limitation and a general lack of uniform regulation governing the development of BPOs may have a significant impact on their future role in servicing.

■ *Appraisals,* or specifically real estate–owned (REO) appraisals, which are specialty appraisals that detail the "good, bad and ugly" of a subject property, provide the highest detail of the solution trio. An appraisal is performed by an individual licensed or certified by his or her state to place a value on a property. Appraisal reports are developed utilizing long-standing procedures guided by both federal and state regulations. While certainly the most thorough means to assign property value, the appraisal is also the most time-consuming and costly.

**Looking forward: Why not the best of all worlds?**

Many moons ago, a colleague looking over the valuation solutions of the day and attempting to settle the "which is best" argument, said, "All are best" when appropriately matched with the assignment and risk at hand. It's like the difference between an adjustable wrench and a torque wrench—both can tighten a bolt, but the torque wrench can tighten a bolt to exact specifications while the adjustable wrench can't.

In today's marketplace, the overwhelming emphasis on rebuilding will come with a high price tag if we don't try to combine proven technologies in new ways to deliver credible results more efficiently.

As an example, some innovative providers are now combining modeled tools with home inspections so property value can be adjusted in a cyber environment based on inspection results. These tools, while not as detailed as appraisals, are excellent supplements to the valuation process. This is especially true in areas where a servicer might strive to get a better view of value by mixing solutions, or where the BPO is embattled.

Other cutting-edge providers are developing new risk-mitigation and monitoring tools that combine modeling with current multiple listing service (MLS), image, mapping and forecast technology.

So, the "match product with risk and assignment" sentiment still rings true in that the possibility of combination keeps all of the individual components honest while increasing efficiency and saving money.

My advice would be to look long and hard at the valuation tools available, and don't be afraid to get creative leveraging raw materials in new ways. Remember, others with similar challenges have done the same with some pretty impressive results. It's definitely worth thinking about on the drive home as you mentally review a spreadsheet while talking (hands-free, of course) with a client and watching the global positioning system (GPS) in your dashboard.

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