

LOAN MODIFICATIONS AND WORKOUTS

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WHY ME?

- What do Compliance Officers have to do with Loan Workouts and Modifications?
- Why should I care?
- Why do I need more work?



WHY ME?

- Generally, modifications and workouts are handled by either the Lending, Collections, Loss Mitigation or Legal Departments.
- The responsibilities of Compliance Officers may overlap with these Departments, but not with always with regard to mods and workouts.
- BUT...



WHY ME?

- Compliance Officers often wear more than one hat at a credit union;
- There are some policies and procedures involved with mods and workouts;
- There may be people here who do workouts!



WHY WORKOUTS?

FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS

January 1 – June 30, 2009

Delinquent loans as a percentage of total loans increased from 1.37% to 1.58%. Delinquent real estate loans as a percentage of total real estate loans increased from 1.20% to 1.62%.

Net Loan Charge-Offs (annualized) increased \$1.93 billion or 41.60%. The ratio increased from 0.85% to 1.15%.



NCUA CU Letter 09-CU-18



WHY WORKOUTS?

- The increase in delinquencies and numbers and dollars of charge offs make it imperative that your credit union take modifications and workouts seriously!
- They can be and are an effective way to stem the rising tide of delinquencies and charge offs.
- NCUA Letter to Credit Union 09-CU-19



WHY WORKOUTS?

- What is a Workout?
 - Any arrangement with regard to a loan, current or delinquent, that enables the member to afford the loan, make the required payments on the loan, or payoff the loan.
- What methods can be used for a workout?
 - Modifications
 - Refinances
 - Settling an account for less than is owed



WHY WORKOUTS?

- It's not the magical cure all
 - One size doesn't fit all
 - Not everyone will be eligible
 - It may just end up being a band-aid
- It's great for MEMBER GOOD WILL and strengthens the credo that credit unions are there for their members in rough times!!!



THE KEY

The key in all workout situations is to **COMMUNICATE** with your member to understand the problems he / she is experiencing, so you know the best way to react, what actions to take and which solutions to offer.



THE GOOD OLD DAYS

- Work outs and modifications were simple...the member made X number of payments, and after that, the account was reaged or modified to bring the member's loan current.
- Used on a more infrequent basis



THE GOOD OLD DAYS

- Mortgages loans were treated similarly
- Additional months of payments may have been required before a mortgage was modified.
- FannieMae has it's own rules.
 - More on those later....



THE REAL WORLD - Unsecured

- Credit Cards, Lines of Credit, Signature Loans
- Several Options
 - Consolidation Loan – Still unsecured
 - Possibly extend the term to reduce payments
 - Consolidation Loans as an equity loan on the member's property
 - Stretches the payment out further with a presumably lower interest rate
 - Even with higher DTI, still have the same debt exposure



THE REAL WORLD - Unsecured

– Advancing Due Dates

- Allows members to skip a payment or payments during rough times.
- Accrued interest will then be paid first
- May extend term of loan if closed end v. open end.

– Converting Loans

- Convert open end loans to closed end loans

– Lowering the Interest Rate on the Loan



WHO DOES WHAT?

- What departments and which employees handle member communications, making new arrangements, approving the arrangements and then adjusting accounts?
 - Collections? Loss Mitigation? Lending?
 - Modifications v. refinances v. reages
 - VP / SVP / CEO
 - Conflicts of Interest.



THE REAL WORLD - SECURED

- Increasing Mortgage delinquency rates require action!
- Stimulus v. Non Stimulus
- FannieMae v. Portfolio Loans
- Rate or principal balance, or both?
- What about equity loans?
- What about including unsecured loans?
- What about cars?



THE REAL WORLD - SECURED

Two types of risk analysis involved

- Risk to the credit union from an income/safety and soundness perspective.
 - CFO/Finance/CEO need to determine what workout terms it will offer to members
- Risk to the credit union from completing a workout that it knows will not be successful



THE REAL WORLD - SECURED

- What options are available for secured loans?
- Modifications
 - Adding the past due interest to the principal of the loan and extending the term of the loan.
 - Need signed modification agreement
 - No interest rate change



THE REAL WORLD - SECURED

- Refinance
 - A new loan, usually at a lower rate
 - May include other subordinate loans, negative escrow, judgments, unsecured debt...
 - Usually processed by the Lending Department
 - What rate does the member get?
 - Current Rate – Not likely because of credit
 - Has management identified any specific workout options that are to be offered to members?



Your Member Sally Sadsack has the following accounts with your credit union

- Savings: \$0
 - Checking: -\$437
 - MM: \$0
-
- Sally's gross monthly income is \$5,000
- In some examples...
- Sally is currently separated from Danny Dontcare. (GMI - \$10,000)



Sally Sadsack

- 1st Mortgage: \$284,000 @ 7%
 - Monthly payment - \$2,700 Escrow - \$700 2 months DQ
- Equity Loan: \$35,000 @ 8.625%
 - Monthly payment - \$ 316 2 months past due
- Appraisal: \$280,000
- LOC: \$10,000 @ 13.9%
 - Monthly payment - \$225 3 months past due
- VISA: \$7,500 @ 9.9%
 - Minimum payment \$250 4 months past due



SALLY SADSACK

- What are your options?
 - Combine all loans and refi at a lower rate-\$336,000 / 7/30 ARM @ 4.5% = \$1,702 + escrow of \$700 = **\$2,402 v. \$3,491**
 - Combine both mortgages and refi at lower rate - \$319,000 / 7/30 ARM @4.5% = \$1,616 + escrow of \$700 = **\$2,316 v. \$3,016**
 - Reage the VISA and Line of Credit, keeping the same payments. Sally to make six consecutive monthly payments.



SALLY SADSACK

- What if only the unsecured loans are DQ?
 - Combine both into a closed ended loan – \$17,500 for 7 yrs. At 9.9% = **\$290/mnth v. \$475**
 - Add the unsecured loans to the equity loan and refinance - \$52,500 @ 7.99% for 15yrs = **\$502 v. \$791**
 - Depending on the circumstances, you may want to just reage and bring them current



SALLY SADSACK

- It's about being creative, listening to the member, assessing the member's problems, evaluating the options available and coming up with the best solution that fits both parties.
- Now, let's add Danny Dontcare into the mix
 - IF Danny is on the mortgage or deed, you will need Danny to sign any refinance paperwork. Without him, Sally will only be sadder



Sally and Danny

- If Sally can qualify on her own, then any refi can be completed without Danny, as long as Danny agrees to come off the deed and mortgage.
- Danny's actions may determine if you will be successful, or end up with a foreclosure, charge off or bankruptcy.



THE REAL WORLD - Attitude

- Members believe that they are entitled to have their loans modified, or should be eligible for a workout, as a matter of course.
 - The Credit Union won't mind...
 - It's not my fault, I have other bills...
- Balance between servicing members and fairness



THE SURREAL WORLD - FannieMae

- The Stimulus Program and FannieMae
 - If you service FannieMae Loans, you must participate in the Stimulus Program for FannieMae loans that you service
 - For portfolio loans, it is optional, and the Credit Union can decide whether it wishes to participate.
 - Added benefit to members
 - Incentives to Credit Union
 - Additional Work for Credit Union



THE SURREAL WORLD - FannieMae

- FannieMae has a COMPLEX set of rules and procedures for qualification in the HMP/HAMP program. (Home Affordable Modification Program)
- Basic Premise – to reduce the interest rate / increase the term on first mortgage loans, in order to lower payments and make mortgages affordable.



THE SURREAL WORLD - FannieMae

- The revised mortgage payment is 31% of the mortgagor's gross monthly income.
- The revised mortgage payment must include principal, interest, escrows for taxes and insurance, flood insurance, condo and homeowner fees. (MI is separate)
- All accrued interest and out of pocket escrow advances are capitalized to arrive at a new principal balance.



THE SURREAL WORLD - FannieMae

- The interest rate on the loan is then dropped by 1/8 point increments until the resulting payment equals 31% of the gross income.
- If this is not possible then...
 - Extend term to 480 months and /or
 - Principal forbearance or balloon payment at the end of the term.



THE SURREAL WORLD - FannieMae

- Borrowers need to submit
 - Tax returns
 - Detailed budget sheets
 - Paystubs no older than 90 days old
- Credit Union needs to obtain
 - Credit report
 - Appraisal



THE SURREAL WORLD - FannieMae

- Borrowers must also be put through the NPV, Net Present Value Test.
- The NPV determines if it is financially sound to go ahead with a modification, and the income stream that the modification will produce
- The results are not used to make the decision whether or not to modify the mortgage.



THE SURREAL WORLD - FannieMae

- Once all this is done, and a modification is appropriate, a Trial Modification Period of 3 – 4 months is set up by agreement.
- If the modified payments are made during the trial period, a full mortgage modification is sent for signature, which officially modifies the terms of the loan.



THE SURREAL WORLD - FannieMae

- The reduced payments are made for 5 years, after which time, the interest rate increases one percent each year, until the interest rate cap is reached, at which time it will be fixed for the remaining term of the loan.
 - The interest rate cap is the Freddie Mac 30 year fixed conforming rate (rounded to the nearest .125%), as of the date the Modification Agreement is prepared.



THE SURREAL WORLD - FannieMae

- Members need to be solicited at the 50th day of delinquency.
- Must be at least 30 days delinquent
 - If not, must pass imminent default test
- Two ways of solicitation
- Onerous reporting requirements



SALLY and DANNY REVISITED

- Would Sally preliminarily qualify for HMP?
 - 31% of her gross salary = \$1,550 (\$5,000 gross)
 - Current payment is \$2,700 – Qualifies
 - Drop interest rate to get P & I of \$850 (\$700 escrow)
 - New interest rate = 2% for 480 months = payment of \$860 + 700 escrow (\$1,560)
 - If Sally and Danny are still married, his income still counts – no HMP 31% of \$15,000 = \$4,650



WHAT, MORE WORK?

- A credit union needs to keep track of the workouts and modifications it completes during the year.
 - NCUA will ask to review all mods and workouts
 - May ask for the reason for each workout
 - Checking that workouts/mods are not being used to make delinquency numbers look better.



SO.....

**WHERE DOES THIS LEAVE
US....**



