Repurchase Rx

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The flood of repurchase demands, and the ongoing headache that it brings to mortgage lenders, appears to be far from over, according to regulatory filings made by the GSEs that estimate 2010 repurchase demands may reach **$21 billion**.

Fannie Mae reports that in the first quarter, lenders repurchased about $1.8 billion in loans, up from approximately $1.1 billion in Q1 of 2009.

Red flags signaling undisclosed debt, income and employment misrepresentation, occupancy fraud and appraisal issues top the list of potential deficiencies most likely to trigger a repurchase demand. As lenders, investors and correspondents each respond with retrospective reviews of thousands of loan files, some key patterns are beginning to emerge that point to a prescription to help manage the headache that can result when an underwriting decision is challenged.

Perhaps the most important lesson learned so far is that the odds of mounting a successful appeal are higher than you might expect. Earlier this year ***The Street*** reported that of the repurchase demands **JPMorgan** is receiving, **50 percent** of the requests have been "successfully rescinded," meaning that they were cured simply by supplying a missing document.

While many are daunted by what seems to be a complex challenge, in reality, a significant portion of repurchase claims can be cleared through a simple process. The primary goal is to demonstrate that the underwriting decision in question was in fact sound at the time the loan was originated. This is done by showing that the deficiencies cited either did not exist or were not the cause of the default. Additionally, it is important to develop a reasonable argument for an alternative cause of the default such as a change in circumstance or a borrower decision to walk away from the loan.

Regardless of the approach to defending the underwriting decision, a successful outcome requires gathering all available evidence, re-verifying loan data to ensure that you have a complete and accurate file, assessing the cause(s) of default and crafting a compelling appeal.

Gather Evidence
The truth is that underwriting decisions are based on information that is often somewhat subjective, such as is the case with property appraisals. Additionally, investors, in their haste to deal with defaults and because of staff and budget constraints, often do not perform thorough investigations. Rather, they send the repurchase demand based on preliminary indicators or red flags that there may be a problem with the origination of the loan. Where there is

subjectivity and lack of verifiable information there is also room for productive debate.

Since the key to defending against a buyback is to demonstrate that the requestor's review is flawed in some way, a good first step is to gather all of the evidence. During this process it is critical to identify elements of the data that can be categorized as opinion rather than fact. For example, in the case of appraisals, if the investor claims the property was worth **10 percent** less than the value used for the underwriting decision, it is very likely that you can challenge the investor's estimate based on empirical studies that show appraisals can easily vary by +/-10 percent. In the evidence gathering process, it is also important to collect data about borrower behavior to build a case for change of circumstance or strategic default. Most often, this information is readily available through servicing data and re-verification of credit, income and assets.

Re-verify the Loan File
There is a common saying in the industry that there is no such thing as a perfect loan file. Verifications may have been performed, but the associated documentation might be missing, or preliminary information may be shown, rather than the final, verified information.

When faced with a repurchase demand, it is critical resolve documentation deficiencies and bring the file up to date with all of the available data to support the original underwriting decision. For example, if an investor cites undisclosed liabilities as a repurchase reason, it can often be proven through a quick, simple verification that the debt was paid prior to close or that it did not belong to the borrower.

Some lenders have hired small armies of in-house investigators to handle retrospective verification, while others have opted to forego hiring and use outside verification experts to secure the necessary documentation. Either way, it is critical to re-verify the loan file to ensure the best chance of a successful appeal.

Assess the Cause
Today, many borrowers, faced with depreciating home values that leave them owing more than their property is worth, are opting for strategic defaults, choosing to walk away rather than make good on their obligations, even though they may have the means to do so. A new study from the **Federal Reserve Board** presents some chilling statistics, finding that strategic defaults in **California** have increased nearly 80 times in the first half of 2009 versus 2005; 53 times in **Florida**; and that among borrowers who bought homes with no money down in 2006 in **Arizona**, California, Florida and **Nevada**, nearly **80 percent** had defaulted by September 2009.

Defaults caused by a change in circumstances related to job loss or income reduction are also more common now. The high national unemployment rate--**9.5 percent** in June--has played a part in driving down credit scores to record lows. **FICO Inc.**, notes that about **25 percent** of consumers (more than **43 million** people) had credit scores below 600 in April. Historically, only about **15 percent** of consumers, or **25.5 million**, have had scores that low.

In these cases, it is a fairly straightforward exercise to build an argument for an alternative cause of default by following a two step process. First, you must verify and document that the borrower's credit standing, estimate of property value, assets and employment at the time the loan met the investor's criteria for the underwriting decision. Then you must offer an explanation and associated documentation to support that the default was either due to the borrower's decision to simply walk away from their mortgage obligation or a change in circumstance such as job loss, divorce or illness.

The telltale signs are the same for change of circumstance and strategic default. Both are characterized by a pattern of consistent payments followed by a marked change in the borrower's payment behavior--data that are readily available through loan servicing files.

Appeal: Timely, Specific and Supported by Documentation
It is critical to respond specifically to each and every repurchase reason, even those that seem flimsy. Your responses should be described fully, in narrative, with documentation to support your rebuttal--the more detail and documentation

you can provide, the better. Timeliness is critical and presents a challenge, given that the response window is generally thirty days; but the time you spend gathering evidence and developing an appeal demonstrates the kind of diligence that can go a long way toward clearing the repurchase claim.

In most cases, your investor wants to continue to do business with you, and would like to clear the repurchase claim in a fair manner. In today's climate, when a problem is suspected with a loan, the investor is often compelled to take action; but many repurchase requests are cleared through the appeal process. This does shift the burden to the lender to appeal; but, given the dollars at stake, the investment in a thorough investigation and appeal is well worth it.

Even when the appeal results in an impasse, where both sides agree to disagree, the loss ratio is usually substantially improved by prompting the negotiation of an alternative resolution that is mutually agreeable. Some alternative resolutions that may be well received by both parties include sharing in the loss or paying for the loss through favorable terms on future sales.

When it comes to an effective approach to treating a headache caused by a repurchase demand, you must build a convincing rebuttal supported by well-documented facts. Mortgage loan decisions are often more subjective than most would like to admit. However, in the case of repurchases, subjectivity opens the door to an opportunity for interpretation and negotiation.

Throughout the process, timely, ongoing communication with the investor is critical. Exercise diligence in performing your own thorough investigation of each loan decision that has been challenged through a repurchase demand. Even if you find that there was an error made, the research will give you valuable insight as to how you can improve your process to eliminate repurchase headaches going forward.