

LOAN REPURCHASES: CRITICAL ISSUES TO KNOW

The cost of an occasional loan repurchase is small in comparison to the profits from originating many more good loans. Managed properly, loan repurchases need not be anything more than another cost of doing business.

BY LAIRD MINOR

(Ed. Note: This is the second of a two-part article. Part one appeared in the last issue of Equity Magazine.)

As noted in part one of this series, loan repurchases have long been one of the mortgage industry's dirty little secrets.

Investors don't like to acknowledge that they sometimes require lenders to take back defective loans, and lenders prefer not to admit that they make mistakes. But the simple truth is that repurchases do happen, in the nonprime, FHA, and even conforming sectors; the prudent lender will be prepared for them.

So, what do you do if this situation occurs?

First, remember that the repurchase of a loan is no different than its original sale: funds and collateral documents much be exchanged (generally through a custodian), files delivered, and servicing transferred.

Three stages of critical importance come into play:

- funding the transaction,
- re-transferring the documents, and
- disposing of the loan afterwards.

All of these require careful planning, but rarely are they given adequate consideration.

Investors often require lenders to fund buy-backs immediately following the repurchase request. This can create a significant liquidity issue for many lenders, especially for those who do not maintain large cash reserves. The typical warehouse line is rarely a funding option; few such lines can accommodate the purchase of closed loans, and even if they do it is unlikely they will permit the purchase of loans which are aged, delinquent, or have other problems.

A warehouse solution

One solution, very useful to large lenders although somewhat difficult to achieve, is to establish a separate warehouse line specifically for the purpose of funding buy-backs. Few lenders offer such lines, but if you have a good relationship with your regular lender and are in a strong financial condition this option is worth exploring. The advance rate obviously will be lower than in your normal warehouse line, and the terms more restrictive, but even this is generally preferable to funding 100% of the repurchase with your own cash.

Another alternative is to negotiate a funding delay with

the investor, to give you time to pre-sell the loan (usually at a discount) in the "scratch and dent" market before you have to retake delivery yourself. In addition, some investors are willing to retain the loan if the lender refunds the difference between the repurchase price and their current estimate of value (often called a "pair-off price").

If that option is available it might be the best approach, because it avoids the necessity of re-selling the loan and re-transferring the servicing (sometimes multiple times). However, the investor's pair-off price may not be the best available, and it is usually worth testing the market and getting competing bids before accepting that offer, especially if it involves multiple loans.

Few lenders intend to keep repurchased loans in invento-

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ry; most must re-sell them, even at a loss, for liquidity reasons.

However, the resale is sometimes made unnecessarily difficult by the investor's document delivery practices. It is common for investors to demand immediate payment of the repurchase price, but then delay re-delivery of the loan file and collateral documents (the note, mortgage, re-assignment, etc.) to the lender. Sometimes this is because the documents are held by a third-party custodian or securitization trustee, and so the delay is not strictly the fault of the investor, but that does not make it any easier for the lender.

The loan cannot be re-sold to a "scratch and dent" buyer without delivery of the collateral, as well as providing a complete pay history, title chain and current servicing information (collection comments, foreclosure status, and even a broker price opinion if one exists).

The lender should not be expected to fund a repurchase without simultaneous re-delivery of the collateral. Investors who make such demands are being unreasonable and should re-examine their practices. Ideally, a lender should negotiate document re-delivery terms in the master Loan Service Agreement (LSA), but at a minimum it should do so at the time of the repurchase request and before disbursing any funds.

Disposition of repurchased loans

Once a loan has been repurchased most lenders will need to re-sell it. This should be done as quickly as possible. Whatever the reason for the repurchase, it is highly unlikely that the value of the loan will improve with age (after all, this is not vintage wine!)

Furthermore, few lenders have the expertise to effectively collect on a delinquent loan or manage a foreclosure. The lender should begin the resale process as quickly as possible, preferably immediately upon receipt of the repurchase demand.

There are investors who specialize in the purchase of distressed loans, and secondary market prices are as strong today as they have ever been. It is important to remember, however, that these buyers have different strengths and weaknesses, which can change over time.

The best buyer of a simple “scratch and dent” loan, which is performing but has some credit issue, may not be the best buyer of a nonperforming loan which is deep into the foreclosure process. Your Secondary Marketing department may know one or two of these buyers, but if they are not in that market regularly they may not know the strongest buyers at any given moment.

Third-party loan advisors with expertise in the “scratch and dent” market can add significant value to the sale of repurchased loans.

Whether you sell the loan yourself or utilize the services of an outside expert, you should expect the sale timeline to be approximately three weeks. The process is quite different than an ordinary premium sale.

The buyer will have to review the entire file carefully, including all compliance disclosures and the collection history. It will also obtain a broker price opinion to verify the value of the collateral. This is a crucial element in the price of any “scratch and dent” loan, even a performing one. You should not expect a buyer to rely on the BPO or AVM you provide, even if it is very recent and from a national vendor; the buyer will typically obtain its own.

Everyone makes mistakes, and mortgage lenders are no exception.

In fact, any nonprime lender that does not have an occasional repurchase or loan rejection is probably being too rigid in its origination process, and is leaving profitable

loans and origination fees on the table. Viewed in this light, the cost of a repurchase once in a while is small in comparison to the profits from originating many more good loans.

Managed properly, loan repurchases need not be anything more than another cost of doing business. ■

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