

Safe at Home

Continued uncertainties in the mortgage market merit cautious approach.

By Karen Bankston

Of all the lessons learned from the bleakest aspects of a calamitous economy, the most nuanced are found in the reality that we really are all in this together: What constitutes misfortune for one member may create opportunity for another, and their credit union mortgage department must be there for both of them.

Mortgage managers are confronting the challenges of continuing to work with current homeowners with persistent financial struggles, while simultaneously keeping pace with new home loan applications for both refinances and purchases at bargain prices. Unlike previous periods of peak demand for mortgages, however, the current response by loan officers and underwriters is more cautious, as credit unions embrace the fundamentals of making the safest possible loan decisions in what remains an essentially risky business.

'Lending 101'

Serving a region hard hit by depreciating home values and 11.4 percent unemployment, Community Credit Union of Florida (www.ccuflorida.org), Rockledge, is going back to "Lending 101"—in the words of CUES member Laurie Cappelli, SVP/lending—to make mortgages that make sense for both its 35,000 members and the \$388 million credit union.

Toward that end, willingness and ability to repay are at the core of how far Community CU of Florida will go to help members stay in their homes. If the former is evident, the credit union refers members to the Balance program (www.balancepro.net) to develop a workable household budget and then start with the question, "How much do you think you can afford to pay?" Cappelli says.

The credit union has developed a Member Solutions program, modeled after a similar program introduced by \$2.8 billion Ent (www.ent.com), Colorado Springs, Colo., last winter, that offers options to lower payments and/or rate or to modify a mortgage to interest-only payments for a year to help members weather the downturn.

"Typically, when you become unemployed, you look to liquidate assets, but you can't do that when your home value is upside down 40 percent," Cappelli says.

Modifications get more complicated when members in financial trouble have both a first mortgage and home equity loan with the CU. "There was a huge home equity lending boom here back when property values were appreciating, and when everything began spiraling out of control, the initial problems surfaced with home equity loans," she notes. "If members are running into problems, they'll stop paying on the second mortgage first, which is now effectively unsecured."

Add to the general economic woes such personal issues as divorcing couples trying to liquidate jointly owned property at a loss, "and it can get very complicated, because people lead complicated lives," she adds. "We've been approached with a lot of issues we've never seen before. It's been quite an educational process for us, which we hope we never have to repeat."

Even with its history of mortgage loans outperforming those of banks and other mortgage originators, the credit union industry is heeding "an important theme that cuts across the entire mortgage industry in the wake of the recession—getting back to basics," says Mark Berkowitz, SVP/general manager representing PMI Mortgage Insurance Co. for CMG Mortgage Insurance Co. (www.cmgmi.com), San Francisco. CMG MI is a joint venture of CUES Supplier member CUNA Mutual Group (www.cunamutual.com) and PMI (www.pmi-us.com).





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Many of the mortgage insurance company’s customers are embracing the “4 Cs” when assessing applications, which Berkowitz lists as the borrower’s character, credit standing and capacity to repay along with the collateral underlying the loan. “Instead of relying on the conclusions of automated underwriting systems, credit unions really should encourage their loan officers and underwriters to scrutinize applications on the basis of what makes the best sense in terms of matching the member to the best mortgage,” he suggests.

Automated underwriting systems may streamline the lending process, but in today’s economic envi-

ronment, loan officers need to perform additional analysis to assess whether property values in the area are flat or declining and to review the member’s credit standing, total debt-to-income ratio and down payment.

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Good News, Bad News

Any optimism about the technical signs of recovery and the bottoming out of housing prices is tempered by persistent joblessness. At Truliant Federal Credit Union, Winston Salem, N.C., for example, “we have seen some encouraging signs, but nothing has stuck,” says Troy Martens, VP/consumer and real estate lending.

The mortgage department for the \$1.4 billion, 180,000-member credit union (www.truliantfcu.org) has been doing a brisk business in refinancing all year, and the demand for construction loans began to pick up this fall, Martens says. In fact, the credit union had some of its most productive mortgage months in 2009.

How Truliant FCU assesses those applications results in part from ongoing quality reviews of its mortgage and home equity loan portfolios “to determine how well our guidelines are serving us in terms of predicting risk,” he explains. “The net result is that we have put more emphasis on

some areas than others. We’re doing more verification of income, and our appraisal guidelines have changed. We take a closer look, with more of an understanding that the value may not be there in the future.”

Taking extra steps to verify income and review applicants’ cash flow has the ultimate aim “to put members in a position for success,” but it also helps to head off mortgage fraud, Martens says. Truliant FCU has seen a small uptick in fraud and attempted fraud in unsecured and auto lending, but no cases of mortgage fraud.

In addition to its own requirements, the CU must base its reviews on the tighter underwriting standards imposed by Fannie Mae and the sometimes even more exacting standards of mortgage insurance companies. The result is that CUs can sometimes get approval from an investor, but not from the mortgage insurer, or vice versa. That layering of approval has become more challenging in recent years, as some mortgage insurance companies have been shut down by the foreclosure crisis.

The foreclosure crisis has had a wide-ranging impact on insurers. For example, in December, Fitch Ratings (<http://reports.fitchratings.com>) downgraded CMG MI to BBB from A+. “Although CMG’s primary default rate has increased,” Fitch’s release noted, “it remains well below its peers”—stronger performance that Fitch attributes partly to CMG’s role in a specific niche, working with credit unions.

“The mortgage insurers still out there have tightened their criteria and have eliminated some programs, making it even more challenging to find the right provider for your loans,” notes Vicky Slate, Truliant FCU’s real estate lending manager.

As a result of those complications, the Truliant FCU mortgage lending team has mulled over the pros and cons of self-insurance. “We have looked at it on a case-by-case basis and determined it would cost our members more money than we would be happy with,” Martens says.

The CU has the option to hold onto some mortgages that may not meet investor and insurer requirements, “and we decide on a case-by-case basis to make those loans if we know the members and their circumstances,” he notes.

The near-cataclysmic turn in the mortgage marketplace and persistent rate of foreclosures underscores a simple guideline for mortgage insurance: “If the down payment is less than 20 percent, credit unions should consider mortgage insurance,” says Joe Dillon, SVP/general

manager representing CUNA Mutual in the CMG MI partnership. “That’s the easiest rule of thumb.”

If a CU is selling the mortgage on the secondary market, it’ll have to have such insurance in place; if the CU is keeping the mortgage, it should have insurance as well. So Dillon’s rule of thumb applies either way.

“In times like these, private mortgage insurance has proven to be a very beneficial credit enhancement,” Dillon notes. “Mortgage insurance companies have paid out millions and millions of dollars in claims to financial institutions over the last several years.”

New Standards, New Avenues

In terms of underwriting standards, most credit unions follow the lead of ever-tightening secondary market guidelines, which call for higher FICO scores, new ceilings for debt ratio calculations and closer monitoring of property values, says Linda Clampitt, senior vice president of CU Members Mortgage (www.cumembers.com), a CUES Supplier member based in Dallas.

As one example, she points to a new total debt ratio of 45 percent from Fannie Mae, effective in December. Other recent requirements include verification of employment within 10 days of closing and obtaining tax returns for all borrowers, not just self-employed applicants.

In addition to its own loan modification program, Community CU of Florida has the option to assist members struggling to make mortgage payments through the federal Home Affordability Modification Program (www.fdic.gov/consumers/loans/hasp/index.html). The guidelines are “complex, ever-changing and cumbersome, but we’re doing our best to help our members who are coming to us for help,” says Christine Dawson, AVP/lending.

There are some encouraging signs that real estate prices may have bottomed out, which is good news for homeowners. For members looking to become homeowners before the cost of housing starts climbing again, Community CU of Florida has introduced its community hero home loan (www.ccuflorida.org/home/loans/mortgage/community). These are 100 percent loans with no requirement for private mortgage insurance; the option is available to qualifying members who are police officers, firefighters, teachers, health care workers, and members of the military. Cappelli notes that the risks inherent in these high loan-to-value loans are mitigated by stepped-up underwriting standards and the

fact that the loans are limited to people in relatively stable professions.

The CU has also begun offering Federal Housing Administration and Veterans Administration loans to expand mortgage options for members through a safe lending conduit, Dawson adds. “In this environment, we’ve had to get a lot more creative with the options we can offer to members.”

For conventional mortgages above 80 percent, it can be more difficult in the current environment to obtain mortgage insurance, especially in still-declining markets, Clampitt says. That’s why more credit unions are looking to FHA loans, which require only a 3.5 percent down payment and credit standards that are not as strict as those of conventional mortgages.

Obtaining “full eagle” status from the Department of Housing and Urban Development to make FHA loans requires an intensive review process, but CUs also have the option to become approved correspondents with a sponsor lender in originating and servicing those mortgages. In 2009, CU Members Mortgage signed up 128 CUs as approved FHA mortgage correspondents.

In addition to challenges with new mortgages, CUs continue to face tough decisions on requests for short sales (a sale of real estate in which the proceeds fall short of the balance owed on the property’s loan). Before reaching the point of short sales, CUs review other options for keeping members in their homes, such as modifying the loan terms or rates or even forbearing the monthly mortgage obligation for a set period to allow members to regain their financial footing, Berkowitz says. “Sustainable homeownership is the catch phrase even in servicing operations. It’s not just good for members and the credit union, but it’s also good for the community.”

Truliant FCU considers requests for short sales on a case-by-case basis. “You’ve got to look at the individual circumstances of the member and the proposed sale to determine what’s going to be your least loss,” Martens explains. “It might make more sense to accept a short sale in one case but not in other cases where you could just try to sell the property later. The same core judgment skills you use in underwriting loans apply to short sales.”

The few short sales Community CU of Florida has dealt with involved second mortgages. In those cases, the standard offered is for \$2,000 to release the mortgage, and “we ask the member to repay the remaining debt, though we may offer a no-interest repayment,” Cappelli explains.

Resources

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Read columns about best practices in lending in these times at cumanagement.org. Choose “Article Archives” then “Operations” and “Lending.” Look for these “Loan Zone” titles: “Troubled Debt Restructuring,” “Planning for Loan Loss” and “After the Golden Age.”


Forward Thinking

What’s next in the mortgage market? “We’ve been calling this environment ‘squirrelly’ because it’s so hard to predict. We have no history to draw on, no base of experience with anything like this,” Cappelli says. “The one thing we do know is that the five-question loan application is going away, and the 15-question loan application is back.”

CUs need as much information as they can gather to make the right loan decisions and head off fraud. “We’ve always known our members,” she adds. “Now we need to get intimate with them.”

To try to get a handle on these unparalleled economic conditions, staff at Community CU of Florida are monitoring trends in the marketplace. Financial Analyst Larry Mach found a research paper (<http://financialtrustindex.org/workingspapers.htm>) on the concept of “strategic default,” the point at which mortgage holders would be most likely to walk away from property with negative equity. Mach put together a model to apply to the CU’s second mortgage portfolio.

There’s also been “a mentality shift for some borrowers,” as Martens puts it, on the basis that “the economy is so bad that people feel it’s up to their lenders to correct the problem.”

For some members who are behind on their mortgage payments, the shift may be because they have never before been in such tough straits and don’t know what to do. For others, “there’s a sense that they may not be as concerned about maintaining their credit because they feel that everybody’s in the same boat,” he notes. “Lenders have to understand that mentality, because it changes the way you look at those loans.” 

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