Future Trends - By Roger Gudobba

True Intelligence

Let's look at the mortgage process in a different way and make a sound judgment on anything about a loan based on more complete information.

Last month in my article "Underwriting Intelligence" I wrote that the lender evaluates a mortgage loan application by asking: 1) is the borrower willing and able to repay the loan? and 2) is the property value sufficient to cover the loan amount? Mortgage loan processing is the most important step in the mortgage loan approval process that decides whether or not the mortgage loan will be approved.

This month I will expand on both the usual way of evaluating the borrower and property as well as looking at some new concepts.

Borrower Intelligence

Typically, the practice has been to have the borrower(s) fill out a Uniform Residential Loan Application, which hasn't significantly changed over the years. The borrower(s) were then asked to provide documentation: Employment/Income- recent pay check stubs, W-2's, and tax returns; Assets- recent bank account statements, list of savings bonds, life insurance, 401K, IRA, stocks or investments and their approximate market values, copies of titles to any motor vehicles that are paid in full; Liabilities- evidence of mortgage and/or rental payments, credit card bills for the past few billing periods, other consumer debt such as car loans, furniture loans, student loans and other personal and cosigned installment loans, copies of alimony or child support. I will talk about the property evaluation later in this article.

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Mortgage processing is the term for all the steps the loan professional takes to assess the borrower's application, using the four C's: credit, capacity, capital and collateral. The processor/underwriter will begin the analysis by sending forms to the appropriate parties to verify that the information presented on the URLA is correct, calculate the ratios, pull a credit report and submit the loan information to an automated underwriting system.

Seasoned professionals will identify any red flags or suspicious information that will take some additional research or clarification.

How do mortgage professionals try to identify these red flags? For example, lenders may ask about the origin of the down payment. If money for down payment is a gift from a relative, it requires a gift letter that states that the money will not have to be repaid.

That's just one example of the tactics lenders can and do use to perform due diligence on the loan to verify the information provided by the borrower.

Every industry has best practices, age-old methods, but those industries that remain relevant evolve over time. Unfortunately our industry is slow in this respect. However, if we are to move forward, some clear changes have to be made. Along these lines, in the book Reckless Endangerment the author states "Fannie Mae led the way in relaxing loan underwriting standards … and automated the lending process so that loan decisions could be made in minutes and were based heavily on a borrower's credit history, rather than on a more comprehensive financial profile as had been the case in the past."

Going further, a recent press release from Equifax stated- With employment and income related misrepresentation continuing to top the list of fraud types that undermine loan quality, financial institutions and their secondary investors and regulators are increasingly diligent regarding oversight of employment verification. In reality, any fraud is a significant cost to the industry and impacts everybody.

Should lenders consider outsourcing borrower validation?

Certainly, to counteract fraud- identity theft, straw buyers, forged employment, payroll records and bank accounts requires additional investigative methods and the use of sophisticated computer technology. In fact, because of the fraudster's ingenuity it will be a moving target. One definition of intelligence is the ability to understand new or trying situations. Companies like Equifax and Fair Isaac are showcasing solutions today.

Could social media, like Facebook and Twitter, play a role?

In May, the Federal Trade Commission notified a California company, Social Intelligence that it was in compliance as a consumer reporting agency, governed by the Fair Credit Reporting Act. In the end, that's the same regulatory authority that covers the companies that report credit scores.

While companies may have every right to look at those sites, they also have serious responsibilities when handling that information. Lenders that haphazardly search the Internet for information run the risk of discovering protected information, such as age, religion and disability. It's probably safer to work with a company to do the checks because that's what they do, they understand the rules.

Property Intelligence

The appraised value of a property is an appraiser's assessment of a home's fair market value, the amount a property would be sold for in a transaction between a buyer and seller when neither is under any obligation to buy or sell. One of the common methods used is the comparable sales approach where the real estate appraiser uses comparisons of properties that have recently sold in the area to determine a value for the property. This means that the subject property is highly influenced by the sales values of other properties that have recently sold in a location.

The large number of foreclosures and short sales on the market has made it more difficult to put values on non-distressed properties. With so many foreclosures and a market that's changing month to month, pricing homes is more complicated and more vital than ever. Foreclosures or short sales do not represent market value, unless there are only foreclosures in an area, then that affects market because it becomes the value.

Property value is impacted by far more than the structure itself. Influences that are geographical, economic, governmental and sociological do impact the final determined value of a property.

The appraiser should be impartial and unbiased. During the financial meltdown it became apparent that was not always the case.

In a recent article, that was written by Liz Green she stated, "Restoring confidence in the mortgage markets and increasing asset quality are dependent upon improved methods of reducing and mitigating collateral risk. In the near future valuations will be 1 part science + 1 part technology + 1 part human."

The Uniform Appraisal Dataset (UAD) will go into effect on September 1st this year and is required by both of the GSEs, Fannie Mae and Freddie Mac in their effort to improve data accuracy and consistency.

So what will change in the future?

You can expect lenders to continue to emphasize data transparency. The System of Record needs to capture accurate data early, ensure that changes are controlled and monitored. The requirement that the data and documents are in sync is a requirement across the end-to-end transaction for all the parties involved in a mortgage.

You can't make a sound judgment on incomplete or ambiguous information.

Next month I will address the mortgage loan products and risk mitigation. ❖

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