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Woodward Asset Capital CEO: 'Financing Must Be Made Affordable To Wider Swathe'

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***PERSON OF THE WEEK*: Whether you're talking about self-employed owner-occupant hopefuls in the retail market or investor buyers in the distressed-asset realm, one common theme that Rodney Carey sees as slowing the housing market's recovery is a lack of financing.**

This week, MortgageOrb sits down with Carey, CEO of Woodward Asset Capital, parent company of VerifiedShortSale.com and OfferSubmission.com, to pick his brain on REO disposition, short sale trends and obstacles to achieving stability in the market.

Q: What do you see as the key steps involved with restoring consumer confidence in the housing market?

Rodney Carey: Homeownership has always been the driver of security and prosperity for the middle-class American. The last few years have forced consumers to re-evaluate and potentially delay this foundational step of purchasing of a home. There are three primary factors that must be addressed before the consumer will have confidence in the housing market again.

The first issue is to stabilize current values. Even though values are at generational lows, the fear that values may continue to decline is the biggest barrier to bringing buyers, especially first-home buyers, into the market.

The second issue that needs to be addressed is the current trend in underwriting standards. It seems that the pendulum has swung to an apex in the opposite direction from where we were at the height of the market, in 2005-2007. The typical W-2 borrower with minimal debt and an excellent credit history is able to obtain conventional financing.

However, self-employed borrowers with a strong credit history, or established credit users with less-than-perfect credit histories, have been removed from the potential buyer pool. Common sense still needs to prevail in the underwriting of loan applications. That is not happening to the extent it should be in order to restore confidence in the application approval process.

Finally, financing must be made affordable to a wider swathe of the population. The Federal Housing Administration (FHA) will insure mortgages with a credit score as low as 580, but the credit overlays required of borrowers with sub-640 credit scores erode the attractiveness of a 4% interest rate. The net result is that the cost of financing is out of reach for many Americans because of rate add-ons or the requirement for a higher down payment, as proposed by Qualified Residential Mortgage (QRM) discussions.

Q: What do you believe are the biggest misconceptions about the marketing and disposition of real estate owned properties (REOs)?

Carey: Overall, I would say the biggest misconception is that banks and the servicing industry don’t understand what is happening at the local level. Recently, there was a news story about how the government-sponsored enterprises (GSEs) were “dumping” properties to get them off federal balance sheets. The story said that was hurting local property values. However, the story based neighborhood values on tax assessor records that had not been updated to reflect recent value declines against REO sales, to show a realistic market value, given condition of the home and overall market activity.

During the last year, the industry has done a great job of implementing processes to effectively manage the market and dispose of inventory. What many people don’t understand is that a bank or servicer may not have the ultimate authority to accept an offer. In many cases, the bank or servicer is hired by a third party (investor), who is responsible for evaluating the acceptability of the offer.

The general public believes that “the bank owns the property and they should be able to absorb the loss.” What they don’t understand is that the “investor” is often a pension fund, like a teacher or fireman’s retirement fund, which has requirements on what type of offer can be accepted, because in all cases, the offer amount is less than the fund lent out initially. It’s a complex problem that has no easy answer and which often leads to misconceptions by the public.

Q: What are your thoughts on the Federal Housing Finance Agency’s recent request for information regarding REO strategies? Do you think the GSEs and the FHA can leverage REO-to-rental conversions and bulk deals successfully?

Carey: I think everyone agrees that the “best” buyer is an owner-occupant. This is traditionally the buyer who is willing to pay the most money for a home (compared to an investor) and become rooted in the community. That said, I also believe the concept of REO-to-rental has some validity if a few items change.

Many properties that GSEs are trying to sell are damaged or suffer significant deferred maintenance that prevents the house from being eligible for traditional owner-occupant financing. An investor usually possesses the skills and financial backing to re-condition the property.

Then, combined with local knowledge of what rents a particular market can support, make this an attractive notion.

The solution would be for the government to alter FHA guidelines to allow for more attractive terms on investor financing. Then, target that program toward investors who could demonstrate a successful history of re-conditioning and managing properties in a defined geographic area. It would be a win-win situation.

One concern that I have with the REO-to-rental notion is in the event that the government ties the program to any type of housing or tenant subsidy program. As a nation, we need to be working to stabilize and improve property values nationwide. A program like this must allow the landlord to establish market rents that are consistent with the neighborhood, without government influence. Coupling this program with a subsidy program will reduce GSE inventory but simultaneously reduce property values of the homes around the subsidized rental home.

Aside from attractive financing options for investors, another roadblock in many communities is the current taxes on these properties. Many communities and municipalities are struggling financially and are often unwilling to reduce property taxes on homes to more accurately reflect the true current value. Because an investor is in this to make money, disproportionally high taxes often do not allow an investor to reach an acceptable cap rate.

Q: What observations can you share regarding the reported growth in short sales over the past few months? To what do you attribute the higher volumes?

Carey: The recent uptick in short sale volume reflects the convergence of resolution on the legal front, more strategic planning by banks and servicers, and homeowners being better educated on their options. The biggest factor has to be the resolution of the consent judgment between the federal government and the 14 top servicers in the industry.

The initial claims by government and subsequent litigation process forced a self-imposed moratorium by servicers on further foreclosures, which also delayed the resolution of short sale requests. Once the judgment was in place and servicers lifted their moratorium, the entire process was again put in motion, only now with a backlog of delinquent loans, which were not able to be resolved during the moratorium.

With the time to foreclose on a property stretching beyond 12 months nationally, and approaching 20 months in judicial states, banks and servicers are seeking alternatives to foreclosure - essentially trying to reduce losses by resolving a delinquent loan before it becomes an REO. The two best options to reduce that cost are a deed-in-lieu of foreclosure (cash for keys) and a short sale. The short sale is proving to be the best way to reduce losses if a modification does not work for the current borrower.

This leads us to the last factor driving an increase in short sales. The effort to aid struggling homeowners has also provided them with an increased understanding of the options available to them prior to foreclosure. It's only recently that "modification" and "short sale" were added to the lexicon of the average homeowner, and with more knowledge, we have seen an increase in requests from homeowners for short sale approvals.

Q: What are servicers' main weaknesses when it comes to short sales and REO sales?

Carey: Many things are working against servicers when it comes to short sales and REOs. There is a seemingly endless chain of lawsuits from the federal government, state governments and the secondary market questioning past or current practices. There are a growing list of requirements from local authorities regarding security and preservation of vacant properties. These are just a few items that lead to weakness, but they are beyond servicers' control.

From the perspective of servicers' main weakness of processes within their control, I would have to say it's the lack of control they have over sales transactions. The amount of fraud and missed opportunity for better recovery dollars is a problem that does not get the attention it deserves. Standard operating procedure has the two most motivated parties in the transaction - buyer and servicer - insulated from each other by third-party vendors and outsourced providers, each with a differing incentive and expectation for performance.

If servicers would be more proactive in ensuring that they are aware of every offer, issues of fraud and lower recovery dollars would vanish. This was the driving principle behind the development of both OfferSubmission and VerifiedShortSale.

From the very beginning, it was evident that when servicers had all offers to consider, they had improved negotiation opportunities, all opportunity for flopping disappeared and the servicer had increased transparency to monitor the progress of the sale. Under the traditional process, the servicer is only aware of what a listing agent makes known. Moving to a process that positions the servicer as the first party to know about all offers, and thus all activity, leaves the servicer holding all the cards for the first time.
