OPERATIONS

# Default, Delinquency: Aggressive Collections Not the Answer

**Techniques that keep communication lines open and preserve broker-borrower relationships help lenders mitigate loss and win fans.**

ALAN TIONGSON, CONSTRUCTIVE CAPITAL

In mortgage lending, loss mitigation is a process where the lender, investor, and servicer work with a borrower struggling with monthly payments (a nonperforming loan) to avoid foreclosure, reducing potential loss to the lender. As our industry becomes increasingly competitive and more complex, the value of loss mitigation is growing. This review provides some potential insight into how you may address similar issues within your organization's portfolio.

As background, loss mitigation options can include, but aren't limited to, repayment plans, loan modifications, forbearances, deferments, short sales, and deed-in-lieu of foreclosure. Although borrowers must meet certain eligibility criteria depending on the hardship faced, the availability of such remedies also depends on all parties (lender, servicer, and borrower) coming to a mutual agreement.

## THE APPROACH

Loss mitigation should be an ongoing daily part of your team's priorities to prevent loss and minimize delinquency. Although loss mitigation review should apply to all loan types, this article will focus on some of the high-level particulars regarding DSCR rental loans, specifically.

There are several key components to a lender's loss mitigation strategy: effective underwriting guidelines, adequate communication, and awareness of fraud prevention.

As the investment property lending industry continually evolves, lenders should be prepared to frequently review and update lending guidelines as needed. Both sales and operations teams should regularly review these guidelines so everyone can collectively account for what shifts they're seeing in the market. Through this constant, internal dialogue, lenders can quickly make necessary changes to prevent potential loss. In addition, the need to constantly evolve fraud prevention and identification practices is critical to any lender's overall success.

## THE PROCESS

Loss mitigation means you will be interacting with borrowers about loans in distress, and the stereotypical, aggressive collections approach just repels troubled borrowers from keeping communication open. Open communication, however, allows lenders/asset managers to gather necessary intel about the reason(s) for default, the status of the collateral, occupancy, and whether the borrower has a realistic, long-term solution to their issue(s).

Keep in mind that if your company generates business through broker referrals or partnerships, it is important to preserve the relationship between broker-borrower. You should allow communication to flow first through that channel before going directly to the borrower. Because the broker has had most of the communication during origination, they tend to get a much warmer reception than a third party with whom the borrower may or may not have had prior communication.

Often, we find that collaborating with borrowers is a much better approach than acting as a "collector" and being combative. The key to success within loss mitigation is keeping communication conversational and trying to understand each investor's circumstances. Seek the root cause of delinquency and explore potential options, the current property status, and whether the issue is short or long-term. Any time you can reach a troubled borrower directly is a perfect time to address all concerns, questions, and potential workout solutions.

Once a loan enters delinquency, it is already known that additional fees, penalties, and default interest may become applicable, making reinstatement even more difficult for a troubled borrower. Assuming the borrower is still in communication, you should approach any potential workout as a negotiation process.

Depending on the loan type, investor, and/or servicer, sometimes workout options such as payment plans, modifications, deferments, or forbearances are allowed if the borrower has some sort of capacity to continue to make payments and typically the issue is temporary. However, if borrower insolvency is the issue, other workout options could include short sales and deed in lieu. In either scenario, a good amount of due diligence is necessary because both release the borrower of any potential deficiency balance that may result from the lender's eventual liquidation of the property. In those scenarios, plan to minimize the length of time to reacquire the property or liquidate versus a lengthy (and costly) foreclosure process.

Being able to note your communications with borrowers and report those notes is critical when managing multiple team members who may have contact with that same borrower. This alleviates the need for the borrower to tell and re-tell their situation, plan, and timelines for resolution. Instead, they're able to pick up where the last conversation left off and focus on whether the borrower is on track with their timeline for any proposed resolution.

## EARLY INDICATORS OF INVESTOR PAYMENT ISSUES

Given the substantial number of loans and the many brokers and borrowers you work with, you should learn to recognize a few specific "red flags" that might show a loan has risk. It helps you focus on those loans rather than having to review all your loans all the time.

Consider taking a deeper look at a loan or following it more closely if any of the following are true:

1. **The investor is constantly looking to refinance.**
2. **The investor already has many loans on the book with you.**
3. **The investor cancels their ACH. ACH is often required for loan repayment, so when a borrower moves to servicing**

**and immediately cancels the ACH, it is a concern. You cannot prevent them from stopping ACH, but you can always ask why they did so.**

4. **The investor has any type of bounced payment.**
5. **The investor is so much as one day late on payment. The grace period for many loans is until the 10th of the month, so if it hits the 11th without payment, start looking into the issue.**

## FRAUD PREVENTION

Although improvements in technology have helped our industry, it has also led to increasing fraud in mortgage origination. As technology and software continue to advance, borrowers have better tools to provide false data or documentation to qualify for financing. In some instances, otherwise ineligible individuals can reverse engineer a lender's underwriting guidelines to better qualify themselves as credible borrowers.

All a lender originating substantial amounts of volume each month can realistically do is develop strong practices and detection measures to prevent/minimize fraud. Detecting fraud is largely dependent on the originations team (primarily underwriting) to detect inconsistencies in financial documentation as well as the chain of property ownership. However, that review is dependent on the individual's attention to detail and/or experience, leaving plenty of room for human error. To help combat this, consider adding an internal committee to review suspected cases of fraud.

Another potential solution is using software/AI as a tool to help identify instances of misrepresentation in borrower financials. These technology tools can detect inconsistencies in financial docs, the font used, transaction types, mathematically check credits/debits, starting and ending balances, etc. These benefits help alleviate the burden of underwriting to manually identify red flags. The key is to bring more company awareness to the potential red flags you face with misrepresentation—on applications, borrower behavior/interactions, purchase contracts, credit reporting, asset documentation, rental leases, appraisals, and titles.

## NATURAL DISASTER IMPACT

Natural disasters can cause varying degrees of damage and create potential risk for lenders. Recent events such as Hurricanes Helene and Milton have shown us how frequently such catastrophes can occur. Every lender should have established policies and procedures to address potentially impacted areas as well as when FEMA officially declares disaster areas. Keep in mind: The assistance you can provide to borrowers depends on the degree of assistance, if any, agreed upon by the institution that owns the loan and servicer.

If a disaster is projected to occur and the potentially affected areas can be reasonably determined, identify the affected properties/loans that have yet to close in these areas. Consider suspending lending in the affected areas until the disaster has cleared.

Following a FEMA disaster declaration, once a confirmed list of affected counties/ZIPs is identified, cross-reference those areas with your active pipeline as well as recently originated loans and request post-disaster inspections/certifications. Having a vendor that can quickly complete these inspections is critical; no investor within the secondary market will want to include a potentially affected loan without being certain the subject property is unaffected. Following a natural disaster, you can require borrowers to sign a certification that guarantees no damage to the property and that no insurance claim was filed.

As the landscape of mortgage lending continues to evolve with new challenges, maintaining adaptability and a focus on robust loss mitigation practices will be key to minimizing losses and supporting borrowers in distress. Lenders, investors, and servicers need to stay proactive in their loss mitigation strategies. Embracing due diligence, open communication, and innovative technology use (e.g., AI and advanced software) can significantly enhance the identification of early warning signs and prevent potential fraud.


### ALAN TIONGSON

Alan Tiongson is the vice president of secondary markets and asset management at Constructive Capital, where he oversees his team, maintains relationships with investors, and oversees overall performance of the portfolio. He has more than 17 years in investment property lending with roles in origination, credit analysis, processing, underwriting, developing/overseeing lending operations, servicing, and portfolio/asset management. Before joining the Constructive team, Tiongson was the director of servicing and asset management with Finance of America Commercial. He graduated from Loyola University Chicago.