GUERRILLA SERVICING

By Martin V. Lavin

The last few quarters have been a challenge for every lender in the manufactured housing industry. All of us have often speculated about how the lending picture will unfold and what the ultimate results will be. Currently, all we know is that it's going on before our very eyes. Although results are soon anticipated, the identity of those affected may yet be a surprise.

The MH lending industry has focused carefully on how it originates loans and the model it uses to ensure the maximum combination of volume and safety. In other words, we want to buy as many loans as possible, but do so with losses not exceeding that certain threshold beyond which they exceed earnings.

The science of this endeavor has been the challenge over the last few years. Unfortunately, the industry refused to learn from the past and became way too aggressive. The models left us wanting; the science found lacking.

I've discussed arcane scoring systems with lenders, the correlation to bureau scores and their meaning. Endless work has been lavished on buying loans, the factors that predict defaults and how these features are built into the system. More work is needed in this area, however.

Before all the automated scoring systems, buying rules and experience provided lenders guidelines. Lenders had, and still have, ideas about how much outstanding credit the applicant should have, the number of late payments that were acceptable on loans, job time, income-to-debt ratios, bankruptcies and a plethora of other factors.

And yet, there came a time—especially as competition stiffened—when loans no one would have purchased just a year before were amounting to as much as 30 percent of everyone's volume in 1997 through 1999.

Competition obviously made lower loan quality much more palatable. So lenders loosened their standards accordingly and the "race" was on. The results have been unpalatable to say the least. Every new generation of MH lenders learns the same thing: past a certain credit level, defaults occur beyond any ability to remain profitable.

So was the buying methodology the big problem that led to the meltdown? The answer to a large measure has to be yes. That said, a number of lenders who faltered and did so before the "Hiroshima" effect of the last year may well have gone awry for other reasons as well.

Specifically, I'm referring to the servicing of loans after their origination, or "collecting." (Yes, I know this word is very much out of fashion!)

Let me be very plain on this matter. Sound originations by themselves won't save lenders from problems anymore than strong servicing, by itself, will keep them out of trouble. Over the last five years, experience has again proven that **both** must be in sync. To be a "world-beater" in our business, the two absolutely indispensable elements are aggressive, but sound originations and guerrilla servicing.

Automated problems

Several of the new lenders formed in the middle 1990s quickly and easily put together sound originating networks. With the help of automated technology, they were able to buy reasonable portfolios relatively quickly. But, for many lenders, the cost and effort that sound servicing capabilities required was underestimated from the beginning.

There's no doubt the newer lenders believed that, with an automated scoring system, they could relieve themselves of some, if not all, of the enormous cost and complexity servicing entails. (Would you believe I still hear that today?)

By the time most of these newer lenders caught on to their real needs—if they ever did before they discontinued their operations—they were in deep trouble. Delinquencies spiked, recoveries floundered, portfolios languished and the overall financial condition of these newer lenders forced many of these portfolios to be sacrificed in the marketplace.

Interestingly, existing MH lenders with superior servicing capabilities subsequently purchased most of these portfolios. Within relatively short periods of heavy servicing, most of those portfolios were turned into good performing assets and rendered very valuable property. Go figure.

So why couldn't the original lender do that? It's a question that could have been asked then and still applies today. For one, not everyone is good at servicing or understands it. Moreover, not every organization has the internal culture that supports its proper execution.

You see, servicing MH loans is very difficult work. It's good old fashion hard work that just isn't all that much fun or trendy. Today, everyone is looking for one more automated this or that to lower the costs and reduce the work.

And our industry requires very specialized knowledge about the collection of troubled loans and disposition of defaulted collateral. In the personal property sector of MH financing, which still encompasses the bulk of most lenders' business, you will be challenged servicing in this industry.

It is this challenge that normally allows us to get 150 to 300 basis points (bps) and more than auto financing. At the other end, our business requires different methods than conventional real estate financing. Too often, however, people coming from the site-built or auto industries have influenced our servicing methods.

Their systems will not work with our product. Our collateral is much harder to dispose of than autos and the velocity of our collection process is quicker than real estate mortgages.

Once the origination has been completed, the servicing process starts. Little has changed in the last 50 years except the automation of information through computerization and application software.

The early servicing process requires auditing the loan and training the borrower as to the lender's expectations within a few days after the closing. This is done so that the borrower confirms the loan and his intent to pay, understands his obligations, knows where to send his payment, the amount owed and the due date.

This is not difficult, but expensive. Unfortunately, many lenders do not take this step, most to their everlasting detriment. This is a very important step, because it really cuts down on early payment defaults and other later problems. In other words, the borrower knows you care, so he does too.

The next necessity is very rapid contact with the customer by phone in the event any due date is not met. The call must be made, the person reminded of their obligations, a commitment to pay is extracted and, if there is a problem, an early appraisal made of the situation.

Notice early intervention is stressed, which means days not weeks. One of the largest MH lenders makes the first call three days after the due date if a payment is not received.

In the last 30 years, I have repeatedly heard of notices mailed out to jolt delinquents and you can use that method if you choose. But there is no substitute for early phone intervention followed by direct personal contact whenever necessary.

I am aware of certain lenders who wait 30 full days before any real action occurs. I remind them on the 30th day of the month that the borrower is two months due. For many financially limited borrowers, that payment gap makes it almost impossible for them to catch up. So barring some forbearance or remaking the terms of the loan, a situation has been created in many cases simply by late intervention. And once the customer believes that catching up is hopeless, you've usually lost him entirely.

One thing that auto finance professionals coming to manufactured housing misunderstand is the difficulty of collateral disposition after repossession. They are fooled by believing that our product can be as easily disposed of as cars. The automobile business has a very systematic channel for resales. In that arena, repossessed collateral can quickly be converted to cash.

In contrast, MH repossessed collateral moves slowly and sells cheaply. The easier it goes, the less recovery. There are exceptions, but unfortunately not enough.

Often, the auto-experienced servicer will be fooled into believing that he can repossess the home quickly and recover its value rapidly. Thus, he may be too quick to try to repossess, not bothering to discipline and counsel the borrower enough.

Intelligent servicers know that, within reason, **anything** that keeps the borrower in the home and the payment stream going is the first objective. Only when that doesn't happen do you go on to the next step.

The servicer coming from the site-built home industry will be fooled into believing that he can lay back, and may be way too slow to react. He may believe, when he gets the home back, he'll net a good recovery and that there is a good network out there to help him dispose of repossessed collateral.

He'll wait for 30 days before the first call, letting that customer get into real trouble. Then, he'll believe that something like a real estate (site-

(continued on page 32)

continued from page 31

Guerrilla servicing professionals are street smart, tenacious, flexible, orderly and have a good sense about when to defer or pursue. They will not let their egos stand in the way of recovery, but they will have big egos.

built) brokerage community exists to help him dispose of the manufactured home. Regrettably, the manufactured housing industry has nowhere near the capability the site-built real estate market has in these cases. The ability of this industry to dispose of repossessed collateral pales in comparison with autos on one hand and real estate (site-built housing) on the other.

Servicing is the key

It's bad enough to have repossessions, but the difficulty and loss upon resales is the real killer in our business. The truth is the average percentage of recovery for MH loans is much less than that of autos or site-built home mortgages. The magic figure in our business is to recover more than 50 cents on the dollar of your loan. The other half (and often much more) will be lost upon repossession and resale. Only the most skilled will get 50 cents or more. I hear some inexperienced outfits only get 25 cents on the dollar. (Help!)

Generally, in both auto and site-built financing, those kinds of losses are rare. In addition, the very difficulty of repossessing the home, to leave it on site or move it, whether to fix it, the winterization, the lot rent, how to market it, and how to price it, are all issues (and more) that must be met. It's a handful.

During those times when repossession activity in the industry is light, you can catch your breath as it's happening. But repossessions tend to come in clumps, coming all together in a compressed period of time, overwhelming the people responsible for the repossessions, and ultimately the whole organization as everyone shares responsibility for repossessing and disposing of defaulted collateral. Anyone going through this process admits it is a morale and energy drainer.

With estimates of 60,000 to 80,000 industry repos in 2000 and 80,000 to 100,000 in 2001, lots of people are drained of emotions and energy in our business. I know that because I talk to them frequently.

One significant advantage bigger industry lenders enjoyed until last year was their large number of sales and servicing offices that were spread out across the country. If there was a problem in Missoula, Mont., someone in these organizations was relatively close by and could take the lead in helping with the collection, repossession, taking custody, determining the remarketing plan and seeing it through to completion. Although many details were still handled by third parties, there was close, hands-on intervention by MH lenders.

And yet, it is not unusual during these periods to see lenders cutting their servicing capabilities when they are needed most. If they hope to recover from their buying mistakes, only sound, disciplined servicing will save them.

Today, as those organizations have shrunk in size, those strengths (and costs) are no longer there. In some cases, the responsibility has been removed from people in the field and is now handled by a much smaller and more centralized force. Out of necessity, this will entail much more reliance on third parties whom lenders do not control and, good as they may be, do not share their sense of urgency.

This has always been the weakness of any lender with a large presence in the marketplace without sizeable personnel cadres. With too much area to cover, few people and little personal involvement, it's a recipe for financial disaster.

Those large national and regional Savings and Loans (S&Ls) of the 1980s lived this nightmare and the RTC sold their portfolios at 27 to 49 cents on the dollar. MH lenders that purchased these portfolios and serviced them well have reported they hit home runs.

In the case of one very large MH lender, the portfolios they purchased had been well originated with scoring systems. Thus, this lender became convinced of the value of such systems after acquiring those portfolios.

As it turned out, however, it was the servicing, **not the buying**, that caused problems. S&Ls were not used to our type of servicing requirements or in many cases were depending on service companies who originated loans for the bank to collect them as well. Although some carried out this activity well, most did not.

So why is servicing so difficult and poorly done by so many?

For one thing, I'm not sure it is all that much fun. I suppose there are those who get up everyday and can't wait to dun people for payment, foreclose on loans, deal with internal legal counsel and the borrower's legal aid lawyer, worry about repossessed collateral, and hurry the winterization of one more abandoned home in Fargo, N.D. But if this sounds like fun to you, call me so I can put you in touch with folks who will value your talents. There are many.

I used a cute phrase—guerrilla servicing—earlier. Just what does that mean? In my mind, that means a finely tuned, trained, experienced servicing arm, with sufficient and highly motivated personnel, who are recognized, appreciated and well compensated by their organization. They take pride in, and they are held accountable for, sound collections, early intervention and loss mitigation.

They walk the line between arrogant persistence and allowable aggressiveness, within the bonds of ethics and the law. They want their money and do not shy away from the things that have to be done to succeed in their goals. They are street smart, tenacious, flexible, orderly and have a good sense about when to defer or pursue. They will not let their egos stand in the way of recovery, but they will have big egos. In my world, they are the 900-pound "guerrillas" of any organization.

The same praise, recognition, compensation and importance assigned to loan originations must be accorded the "other" side (they aren't agents of the **dark side** either). They can make you look good or they can have you looking like a fool. You decide. □

Martin V. Lavin is an attorney and 28-year veteran of the manufactured housing industry, with special emphasis on lending. He lives in Burlington, Vt., and represents Mortgage Services Inc. and Mobile Home Lending Corp. Contact him at 802/862-1313 or by e-mail at MHLMVL@aol.com.