

No-Escrow Feature Is 'Taxing' for Loan Mods

American Banker | Tuesday, July 28, 2009

By [Kate Berry](#)

Adjustable rates, undocumented incomes and pick-a-pay options get more publicity, but another feature from the subprime mortgage boom is jinxing today's loan modifications.

During the boom, loans were often set up without an escrow account for property taxes and insurance, which traditionally are collected monthly by the servicer along with principal and interest. Leaving taxes and insurance out of the monthly bill made the mortgages look more affordable to borrowers (who often got hit later with a large annual or semiannual tax bill).

Today, many of these subprime borrowers are trying to get loan modifications. But servicers generally require that an escrow account be created as a condition of rewriting loan terms. This is one reason that so many borrowers who get modifications redefault, observers said.

"The payment after a loan modification may end up being higher than it was before because of taxes and insurance," said Kim Gawronski, senior director of operations at First American Real Estate Tax Service. "Leaving out the taxes and insurance to get a borrower into a cheaper loan was one of the less-discussed subprime practices and is emerging as an impediment to mods."

More than half of subprime loans lack escrow accounts, according to Gawronski. (Her company, a unit of First American Corp. in Santa Ana, Calif., tracks for lenders whether property taxes have been paid on mortgaged homes.)

"We're finding [that] many borrowers don't even know what escrow is, or that [their] taxes aren't escrowed," said Greg Hebner, the president of MOS Group Inc., an Irvine, Calif., company that reaches out to troubled borrowers on behalf of lenders and servicers.

Steven Horne, the president and founder of Wingspan Portfolio Advisors, a Carrollton, Tex., servicer specializing in highly delinquent loans, said some servicers will modify a loan only to realize later that taxes and insurance payments are past due.

"The resulting demand for lump-sum or increased escrow payments frequently blows up the prior mod," he said.

A report released by regulators last month said about 19% of all modifications by national banks and thrifts in the first quarter of this year increased borrower payments. Half the loans whose payments went up became delinquent within six months.

Of all the loans that were modified in the first quarter of last year, 33% are now seriously delinquent, and 13% are in foreclosure, the report said.

Regulators have been urging servicers to offer loan modifications that reduce monthly payments because of their lower redefault rate.

"If you reduce the payment significantly, you can make an impact," Comptroller of the Currency John Dugan said in April.

Servicers and lenders want to make sure property taxes are paid because, if a municipality places a lien on a home, it stands in the repayment line ahead of the loan.

"If the taxes aren't paid, the lender can lose the property to a tax bill," Gawronski said.

Hence, a servicer or lender will often front overdue tax and insurance payments and try to collect them later from the borrower.