Analysis: Structuring & Optimizing the Recovery from Your NPL Portfolio

This document outlines Issues to be considered when deciding how to recover the optimum net value from a portfolio of Non Performing Loans.

A. Objective

Maximize recovery of value from a portfolio of non-performing mortgage assets, all things considered (see D1), with minimum risk.

B. Key Decisions

1. "Fight or Flight", should assets be sold or held?
   a. If Sold, Sell Outright or on Contingency? (Regulatory & FAS Implications)
   b. If "Hold", how to value, how to manage, specialty vendors

2. Resources/Third parties needed to effectuate Recovery Plan.

C. Decision Process

1. Determine what options ("Scenarios") owner *can* consider (see G)

2. Establish Desirability (more than just money) to owner in various Scenarios

3. Proceed with Most Desirable/Optimum Scenario

4. Considerations
   a. Who will fund/perform the Scenario & Asset Valuation Processes?
   b. If outside vendors: Justify selection/cost, Approve process/metrics

D. Determine Desirability of Various Scenarios

1. Consider/score all factors that together determine most desirable outcome, including financial, regulatory, liability and other business considerations.

2. Define/Justify "desirability" factors (i.e. speed of resolution, amount of money, reputation, confidentiality, regulatory compliance, investors)

3. Determine values for "desirability" metrics for each factor

4. Verify/Review/Document entire process

E. Key Factors to Consider

1. What are the most important goals?

2. What options/scenarios **can** the owner consider? (Status/mood of other voting owners, legal/regulatory/investor restrictions/XXX)

3. Type of Assets: NPL, MBS, CDO, or Fund shareholder or benefitiary

4. How quickly must a resolution be achieved?

5. What time, money and resources is the owner prepared to invest?
   a. Investment just to accurately evaluate/value each loan
   b. If not being sold, costs to execute/monitor recovery operations

c. Additional advances needed (tax, legal) relative to net recovery
d. if being sold, sales costs, including retrieval of original loan files

6. Access to computer models for Portfolios over few dozen loans
   a. Multiple variables (See F) for *each* Loan
   b. Peer review/document assumptions

F. Factors Affecting NPV & Recovery Effort

For *each* individual loan in the portfolio, determine:

1. Is the loan current or delinquent, if so how long?
   a. Loans non-performing more than 3-4 years are considered *"Legacy"*, and require more specialized/costly "Forensic" analysis and recovery.

2. Is Loan (and realty collateral) Commercial, Residential, or land?

3. Loan NPV is greater of: Discounted Net Collateral Value or Net Secured Borrower Deficiency Judgment after B/K. Analysis must consider both.

4. What is the loan collateral (Real Estate) Worth?
   a. Geographic market (speculative bubble, Rust Belt)
   b. Type of Resi property (condo v single family, conversion v new construction)
   c. Owner Occupancy v Investors/speculators in surrounding project
   d. Post Foreclosure Value (BPO, program values, inspections)

5. Market Risk: is the trend up, down or steady for:
   a. Real Estate Values
   b. Interest Rates
   c. General and Local Economy & Employment (PsychoD's, macro trends)
   d. Political climate and 36 month prognosis

6. Loan Priority
   a. First, second, etc.
   b. Property Tax liens, Condo Liens, other superior liens
   c. Rate of growth of senior liens (i.e. NPV of your assets shrinks)

7. Borrower Bankruptcy Risk (Collection delay/cost, Deficiency risk)
   a. Exemption in Local Jurisdiction
   b. Each borrowers eligibility to file B/K

8. Financial condition of Borrowers (Judgment Deficiency Risk)
   a. Nothing to lose v. Solid but episodic problem
   b. Borrower's other assets (deficiency judgment would be collectible)
   c. Borrower liability re Loan (Stated Income, other culpabilities)

9. Environmental Risks (Commercial/Land)
   a. Contamination (this or adjacent property)

10. Lender Liability on Subject Loans
    a. Scratch & Dent
    b. Predatory
    c. Other real or prospective liability, Reputation of Loan originator(s)

For the *entire* NPL Portfolio, and the Recovery/Sales *Process*:

11. Layering Impact on Values (i.e. allow for affect on collateral values due to associations between, and compounding of, multiple factors).

12. Relative "Supply and Demand" for: NPL Portfolios, Collateral, market "mood" fiscally and politically, Regulatory issues for portfolio owner.

13. Opportunity Cost (what would you do/earn if funds in hand now?)

G. Resolution Plans

1. Develop various "Resolution Scenarios", and consider:

2. Owners status/reputation with Regulators and Investors (current reserves v charges if sold, need to "clean house" before mergers)

3. Expertise & Resources of Loan Owner or Servicer

4. Time Constraints
   a. Deadline to resolve/close a loan or the portfolio
   b. Mergers or Regulatory Approvals pending

5. Regulatory Considerations
   a. Constraints on Collection
   b. Ratios of Loans, geographically, etc.
   c. Divestiture of Loans for pending Mergers (inc. Wall Street analysts)

6. Reputational Considerations
   a. Foreclosures, certain markets, ethnicities, etc.
   b. Perspective of Investors/major stock holders
   c. Future business with "class" of borrowers/constituents

7. Estimate of net recovery – internal or contingency collection v. Sale

8. If portfolio is sold, Marketing & bids/auction vs. Negotiated sale(s) (appropriately documented) to known buyer(s)

Conclusions

The true Net Present Value of a NPL portfolio or related assets, and what constitutes the most desirable disposition for a particular owner, all things considered, involves much more than simply *"how much can we get"*.

These questions can be reasonably determined if: (1) the factors identified in Section F of this outline are considered for each loan, and (2) all of the other issues are considered for the portfolio and the parties.

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