

U.S. Structured Finance Newsletter

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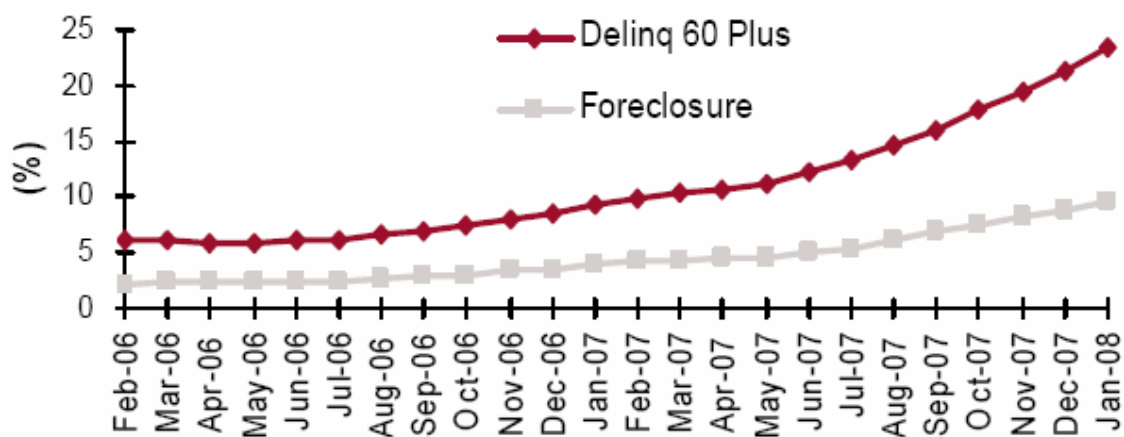
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DEFICIENCY JUDGMENTS EXPECTED TO RISE

As loss severities continue to rise as a result of the depressed U.S. housing markets, mounting foreclosure inventories and lengthening liquidation timelines (see Exhibit 1), some servicers are considering the increased use of deficiency judgments as a way of trying to recoup losses. A deficiency judgment is a lien placed against the borrower by the lender when a judicial foreclosure sale does not satisfy the amount owed on the mortgage. For example, if a borrower owes \$100,000 to a mortgage lender and the proceeds after the foreclosure sale are \$60,000, the difference of \$40,000 can be filed as a judgment against the borrower. The judgment appears on the borrower's credit report and can have an impact on the ability of the borrower to obtain credit in the future. Depending on the laws of the state, the lender may also be allowed to take further legal action, such as garnishing wages, to pursue payment of the debt. Typically, mortgage lenders do not pursue wage garnishment but instead wait for the borrower to attempt to purchase a new home and negotiate a settlement on the lien. Any money obtained through the settlement process is treated as a recovery in a securitized transaction.

Exhibit 1: Delinquency and Foreclosure Rates on Subprime Outstanding



Source: Credit Suisse, LoanPerformance

While some servicers are planning to increase their use of deficiency judgments, others have stated that, when possible, they will continue to use non-judicial foreclosures because of the high cost of working through the courts in a judicial foreclosure. Since deficiency judgments are not typically filed in non-judicial states, servicers usually write off any lost proceeds and issue a Form 1099 obliging the borrower to pay taxes on the amount that was written off, preferring instead to pursue judgments only in instances where the homeowners have large liquid assets.

Given the continued expectation for an unprecedented level of distressed borrowers and the rise in outsourcing companies that can perform the recovery function, DBRS expects that servicers will begin to file more deficiency judgments than in the past. Historically, even if deficiency judgments were filed, servicers did not automatically pursue them, believing that people who lost their homes to foreclosure would be unlikely to have the funds necessary to pay the judgment. In today's environment, however, many borrowers facing foreclosure are overextended but can afford to buy a cheaper home or rent. Since these borrowers often have some cash, many argue that it is worth the expense of pursuing a judgment even if they are only able to recoup ten cents on the dollar. As a result, DBRS will continue to monitor the servicing industry for trends with regard to the use of deficiency judgments as a loss-mitigation tool and its future impact on deal performance.

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