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In Everyone's Best Interests

Maintenance agreements offer lenders a way to preserve nonperforming assets



Illustration: Dennis Wunsch

When it comes to real estate owned (REO) properties, maintenance costs can add up quickly. A leaky roof can result in \$10,000 of mold and drywall repairs. A neglected lawn can lead to thousands of dollars in landscaping costs. City-building-department fines and homeowners association (HOA) dues can add up to thousands more in late fees and attorney costs. Perhaps most significant, however, are the unaddressed life-safety issues often present in REOs — hazards that can create negligence claims the moment a property's title changes. When a home goes into foreclosure, many servicers lower their price by 15 percent simply to allow for deferred maintenance.

Suffice it to say that REOs with neglected maintenance issues can pose major financial risks to the financial

organizations that own them. When homeowners stop paying their mortgages, it's often the case that they stop paying to maintain their homes, as well. With that in mind, how can mortgage bankers and lenders mitigate their maintenance-related risks and, in turn, increase their returns on loans funded?

To a large extent, the best way to control pre-foreclosure deferred maintenance is fairly simple: Help your borrowers with their maintenance needs before their properties go into REO.

Strike a deal

If your bank discovers that one of its nonperforming properties is being neglected in terms of maintenance, consider offering the borrower an external property-maintenance agreement. This agreement could be put into place when determining whether

to do a mortgage modification or forbearance agreement and, among other uses, could provide funds for the home's roof to be fixed, its lawn to be maintained, its exterior to be painted or its HOA dues to be paid in full.

Paying for these maintenance issues would be done as an advance to the loan to protect the bank's interest. As a bonus, the bank will demonstrate goodwill to the surrounding area by keeping one

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more well-maintained home in the neighborhood. Further, the borrower may be less frustrated with the bank, so much so that the borrower may be less inclined to actively harm the home in the event of a foreclosure.

Although external property-maintenance agreements initially can be a cost in and of themselves, they allow a home to upgrade itself to a better condition and thus can help you maximize its value should the asset eventually be sold at a short sale or REO.

The specifics

Most loan agreements include language that allows a bank to protect its interest in the asset, but these clauses primarily are aimed at making tax, hazard or mortgage-insurance payments should the borrower fail to do so. It's likely, then, that an organization's attorneys will recommend that the borrower and the bank sign a separate agreement to address property maintenance.

In most instances, this agreement also will have to be signed by the property-preservation company assigned to do the work. Regardless, the agreement should:

- **Specify what work has to be done;**
- **Detail the cost of the work to be done;**
- **Determine the time within which the work will take place; and**
- **Grant the property-preservation company access to the property to do the work.**

When drafting external property-maintenance agreements, banks and other financial institutions should consider a number of factors. For instance, when it comes to choosing a property-preservation company, banks should work only with trusted companies with a minimum of \$1 million in errors-and-omissions insurance. With regards to the external property-maintenance agreement itself, a bank should be sure that any such agreement fulfills the following six conditions:

- 1. The bank must make it clear that the offer to perform maintenance is not connected with any other loan program** that the bank may offer. Further, the borrower must understand that the agreement will be in place until the house's problematic state is resolved, whether that resolution is reached via foreclosure, outright sale, short sale, bringing the loan current or modifying the loan. It must be clear to the borrower that, even if the property is being foreclosed, the property's maintenance still will continue under the terms of the agreement.
- 2. The borrower must understand that the external maintenance agreement is not an opportunity to upgrade** the home's landscaping or amenities. Maintenance should be limited only to items identified specifically in the agreement.
- 3. The agreement must include a mechanism to add new items to the list of those being maintained.** Of course, a home's condition and needs can change over time — air-conditioning units can fail, and inclement weather can damage fences and bring down trees. A bank may consider granting certain clients an established minimum automatic approval of approximately \$200 to address repairs that are not specified in the initial external maintenance agreement.
- 4. An emergency-repairs budget should be specified.** Much like the previous provision, the agreement should contain a mechanism to add items at any given time. If plumbing breaks, it can do thousands of dollars' worth of damage in a short period of time to carpets, walls and ceilings. In this case, you would want to encourage the borrower to call the property-preservation company to stop the water leak before bringing in a team to dry out the house. Any issues with doors, windows, skylights, clogged gutters and exposed electrical wiring also should be treated

as emergency repairs and, accordingly, should be completed as soon as possible. If windows or doors are being repaired more than once due to abuse, the bank or lender must be notified and determine whether it wants to continue with the agreement. If it does want to continue with the agreement, the bank or lender should have the option of using plywood to make repairs.

- 5. The agreement should describe examples of repairs that are outside the scope of the external maintenance agreement** and are solely the responsibility of the borrower. These may include such minor repairs as clogged toilets, blown fuses, broken garage-door openers, torn screens, broken appliances, basic interior cleaning and alarm systems. An organization also should be sure to make it clear that these are only some of the items excluded from the agreement.
- 6. It should be clear that the external maintenance agreement is not a rental agreement,** and that it's at the bank's discretion to continue maintaining the exterior of the home, as well as its landscaping. The agreement should clarify that the bank has no responsibilities to make interior repairs or to meet local tenant laws.

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All things considered, external property-maintenance agreements can be beneficial to both parties involved in a nonperforming property. A borrower will receive a well-maintained home and, hopefully, will get re-engaged in keeping the property, making a loan modification easier to complete and giving the borrower more interest in keeping the mortgage current. If the borrower doesn't, the bank has a well-maintained asset that's comparatively easier and more lucrative to sell than it would be if the home were in disrepair. In other words, external property-maintenance agreements can be a win-win situation for everyone involved. ●