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How to Find Weeds in a Mortgage Pool

By GRETCHEN MORGENSON

IT sounds like the Domesday Book of the housing bust. In fact, it is a computerized compendium of millions of housing transactions — a decade's worth from across the country — that could finally help us get to the bottom of troubled mortgage investments.

The system is an outgrowth of work done by a New York investment manager, Thomas Priore. In the boom years, his investment firm, ICP Capital, navigated the dangerous waters of collateralized debt obligations via an investment vehicle called Triaxx. Buyers of Triaxx C.D.O.'s did better than most, but Triaxx still incurred losses when the bottom fell out.

Now Triaxx's database could help its managers and other investors identify bad mortgages and, perhaps, learn who snookered whom when questionable home loans were bundled into investments that later went bad.

Triaxx's technology came to light only last month, in court documents filed in connection with the bankruptcy of Residential Capital. ResCap was the mortgage lending unit of GMAC, now known as Ally Financial. As an investor in mortgage securities, Triaxx gained access to a lot of information about loans that were pooled, including when those loans were made, where the properties are and how big the mortgage was, relative to the property's value. After Triaxx fed such details into its system, dubious loans popped out.

Granted, Mr. Priore is no stranger to controversy. He and ICP spent two years defending themselves against a lawsuit by the Securities and Exchange Commission, which accused them of improperly generating "tens of millions of dollars in fees and undisclosed profits at the expense of clients and investors." On Friday, ICP and Mr. Priore settled the matter. As is typical in such cases, they neither admitted nor denied the accusations. Mr. Priore paid $1.5 million. He declined to discuss the settlement.

But he did say that, looking ahead, he believed that Triaxx's technology would help its investors recover money they deserved. Many other investors, unable or unwilling to dig through such data, have settled for pennies on the dollar.

"Our hope is that the technology will level the playing field for mortgage-backed investors and provide a superior method to manage residential mortgage risk in the future," Mr. Priore said.

A step in that direction is Triaxx's recent objection to a proposed settlement struck last May between ResCap and a group of large mortgage investors. Triaxx, which invested in mortgage loans originated by ResCap, criticized that settlement because it was based in part on estimated losses. Triaxx said the estimates had assumed that all the trusts that invested in ResCap paper were the same. Triaxx argued that a settlement based on estimated losses, rather than one based on an analysis of actual misrepresentations, unfairly rewards investors who bought ResCap's riskier mortgages.

ResCap replied that it would be a herculean task to examine the loans in the trusts to determine the validity of each investor's claims. But Triaxx noted that it took only seven weeks or so to do a forensic analysis of the roughly 20,000 loans held by the trusts in which it is an investor. Of its investments in loans with an original balance of $12.8 billion, Triaxx has identified approximately $2.17 billion with likely breaches. A lawyer for ResCap did not return a phone call on Friday seeking comment about problem loans.

John G. Moon, a lawyer at Miller & Wrubel who represents Mr. Priore's firm, said: "Large institutions have been able to hide behind the expense of loan file review to evade responsibility for this very important national problem that we now have. Using years of data and cross-referencing it, Triaxx has figured out where the bad loans are."

Triaxx, for example, said it had found loans that probably involved inflated appraisals. Those appraisals led to mortgages far exceeding the values of the underlying properties. As a result, investors who thought they were buying mortgages that didn't exceed 80 percent of the properties' value were instead buying highly risky loans that totaled well over 100 percent of the value.

Triaxx identifies these loans by analyzing 50 property sales in the same vicinity during the same period that the original mortgage was given. Then it compares the specific mortgage to 10 others that are most similar. The comparable transactions must involve the same type of property — a single-family home, for example — of roughly the same size. They must also be within a 5.5-mile radius. If the appraisal appears excessive, the system flags it.

Phony appraisals in its ResCap loans likely resulted in $1.29 billion in breaches, Triaxx told the court. Triaxx cited 50 possible cases; one involved a mortgage written in November 2006 on a home in Miami. It was a 1,036-square-foot single-family residence, and was appraised at $495,000. That appraisal supported a $396,000 mortgage, reflecting a relatively conservative 80 percent loan-to-value ratio.

But an analysis of 10 similar sales around that time suggested that the property was actually worth about $279,000. If that was indeed the case, that $396,000 mortgage represented a 142 percent loan-to-value ratio.

Perhaps the home had gold-plated bathroom fixtures and diamond-encrusted appliances. Probably not.

Triaxx's system also points to loans on properties that were not owner-occupied, a breach of what investors were told would be in the pool when they bought it, Triaxx's filing said. Such misrepresentations in loans underwritten by ResCap amounted to $352 million, Triaxx said.

The technology also kicks out mortgages on which borrowers failed to make even their first payments, loans that should never have wound up in the pools to begin with.

Although Triaxx is using its technology to try to recover losses, that system could also help investors looking to buy privately issued mortgage securities. After all, investors' inability to analyze the loans in these pools during the mania led to enormous losses in the collapse. Now, deeply mistrustful of such securities, investors have pretty much abandoned the market.

Lenders and packagers of mortgage securities will undoubtedly fight the use of any technology like Triaxx's to identify questionable loans. That battle will be interesting to watch. But investors should certainly welcome anything that brings transparency to this dysfunctional market.