

**GAO**

Testimony

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Government Reform, House of  
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# TROUBLED ASSET RELIEF PROGRAM

## Home Affordable Modification Program Continues to Face Implementation Challenges

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**GAO**

Accountability \* Integrity \* Reliability



Highlights of [GAO-10-556T](#), a testimony to the Committee on Oversight and Government Reform, House of Representatives

## Why GAO Did This Study

Mortgage loan defaults and foreclosures are key factors behind the current economic downturn. In response, Congress passed and the President signed the Emergency Economic Stabilization Act of 2008, which authorized the Department of the Treasury to establish the Troubled Asset Relief Program (TARP). Under TARP, Treasury created the Home Affordable Modification Program (HAMP) as its cornerstone effort to meet the act's goal of protecting home values and preserving homeownership. This statement focuses on (1) HAMP's program activities to date, (2) status of GAO's July 2009 recommendations to strengthen HAMP's transparency and accountability, (3) preliminary findings from GAO's current work evaluating servicers' implementation of HAMP, and (4) additional challenges HAMP faces going forward.

GAO obtained information from 10 HAMP servicers of various sizes that accounted for 71 percent of the TARP funds allocated to participating servicers. GAO reviewed their policies and procedures, interviewed management and quality assurance staff, and observed a sample of phone calls between borrowers and servicers. GAO is also reviewing samples of loan files for borrowers offered and denied HAMP trial modifications. Finally, GAO spoke with officials at Treasury and its financial agents—Fannie Mae and Freddie Mac—and is analyzing program information and data from these sources.

View [GAO-10-556T](#) or [key components](#). For more information, contact Mathew Scire at (202) 512-8678 or [sciremj@gao.gov](mailto:sciremj@gao.gov).

## TROUBLED ASSET RELIEF PROGRAM

### Home Affordable Modification Program Continues to Face Implementation Challenges

#### What GAO Found

When Treasury announced the program in March 2009, it estimated that HAMP could help 3 to 4 million borrowers. Through February 2010, including both the portion funded by TARP and the portion funded by Fannie Mae and Freddie Mac:

- about 1.1 million borrowers had begun trial modifications; of which
- about 800,000 were in active trial modifications, and
- fewer than 200,000 permanent modifications had been made.

As of early March 2010, the TARP-funded portion of the program had 113 participating servicers, and about \$36.9 billion of the \$50 billion in TARP funds for HAMP had been allocated to these servicers. A typical TARP-funded modification could result in a monthly mortgage payment reduction of about \$520.

Treasury has taken some steps, but has not fully addressed concerns that GAO raised in its July 2009 report on HAMP's transparency and accountability. For example, Treasury has yet to finalize some key components of its internal controls over the first-lien program, including establishing metrics and benchmarks for servicers' performance. In addition, Treasury has not finalized remedial actions, or penalties, for servicers not in compliance with HAMP guidelines. According to Treasury, these remedies will be completed in April 2010. Lastly, GAO reported that Treasury's projection that 3 to 4 million borrowers could be helped by HAMP was based on several uncertain assumptions and might be overly optimistic, and GAO recommended that Treasury update this estimate, but the Department has not yet done so.

Preliminary results of GAO's ongoing work show inconsistencies in some aspects of program implementation. Although one of HAMP's goals was to ensure that mortgage modifications were standardized, Treasury has not issued specific guidelines for all program areas, allowing inconsistencies in how servicers treat borrowers. For example, the 10 servicers GAO contacted had 7 different sets of criteria for determining whether borrowers who were not yet 60 days delinquent qualified for HAMP. Also, some servicers were not systematically tracking all HAMP complaints and, in some cases, tracked only resolutions to certain types of complaints, such as written complaints addressed to the company president. GAO also found that servicers faced challenges implementing HAMP because of the number of changes to the program, some of which have required servicers to readjust their business practices, update their systems, and retrain staff.

HAMP is likely to face additional challenges going forward, including successfully converting trial modifications, addressing the needs of borrowers who have substantial negative equity, limiting redefaults for those who receive modifications, and achieving program stability. While GAO's study is not yet completed, GAO shared preliminary findings with Treasury to allow it to address these issues in a timely manner.

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our work on the Home Affordable Modification Program (HAMP), which the Department of the Treasury has implemented under the Troubled Asset Relief Program (TARP). Dramatic increases in home mortgage defaults and foreclosures have been at the root of the current economic crisis. In response to the turmoil in the financial markets, the Emergency Economic Stabilization Act of 2008 (the act) authorized Treasury to establish TARP and to purchase and insure up to \$700 billion in troubled assets from financial institutions through TARP.<sup>1</sup> Treasury's initial focus in implementing TARP was to stabilize the financial markets and increase lending to businesses and consumers, but the authorities granted to Treasury under the act were also to be used to preserve homeownership, protect home values, and maximize assistance for homeowners with respect to foreclosure mitigation efforts. On February 18, 2009, Treasury announced the framework for HAMP, a program that would use up to \$50 billion of TARP funds to help at-risk homeowners avoid potential foreclosure, primarily by reducing their monthly mortgage payments.

My statement today is based on our July 23, 2009, report on HAMP and our current work evaluating Treasury's ongoing implementation of the program.<sup>2</sup> Specifically, this statement focuses on (1) HAMP program activities to date, (2) the status of the recommendations we made in our July 2009 report to strengthen the transparency and accountability of HAMP, (3) preliminary findings from our current work evaluating servicers' implementation of HAMP, and (4) additional challenges HAMP faces going forward. Our current work evaluates servicers' practices in informing borrowers about HAMP, the extent to which servicers have been consistently evaluating borrowers for HAMP participation, and the processes that have been put into place for borrowers to file HAMP complaints. To examine these questions, we spoke with and obtained information from 10 HAMP servicers of various sizes that collectively represented 71 percent of the TARP funds allocated to participating

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<sup>1</sup>Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632 (2009) amended the act to reduce the maximum allowable amount of outstanding troubled assets by almost \$1.3 billion, from \$700 billion to \$698.741 billion.

<sup>2</sup>GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, [GAO-09-837](#) (Washington, D.C.: July 23, 2009).

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servicers and visited 6 of them. We reviewed their policies and procedures, interviewed management and quality assurance staff, and observed a sample of phone calls between borrowers and their servicers. We are also reviewing samples of loan files from each servicer for borrowers who were offered and denied HAMP trial modifications. Finally, we spoke with officials at Treasury and its financial agents—Fannie Mae and Freddie Mac—to understand how they were ensuring compliance with HAMP guidelines and their processes for resolving HAMP complaints. We are coordinating our work with other oversight entities that TARP created—the Congressional Oversight Panel (COP) and the Office of the Special Inspector General for TARP (SIGTARP).

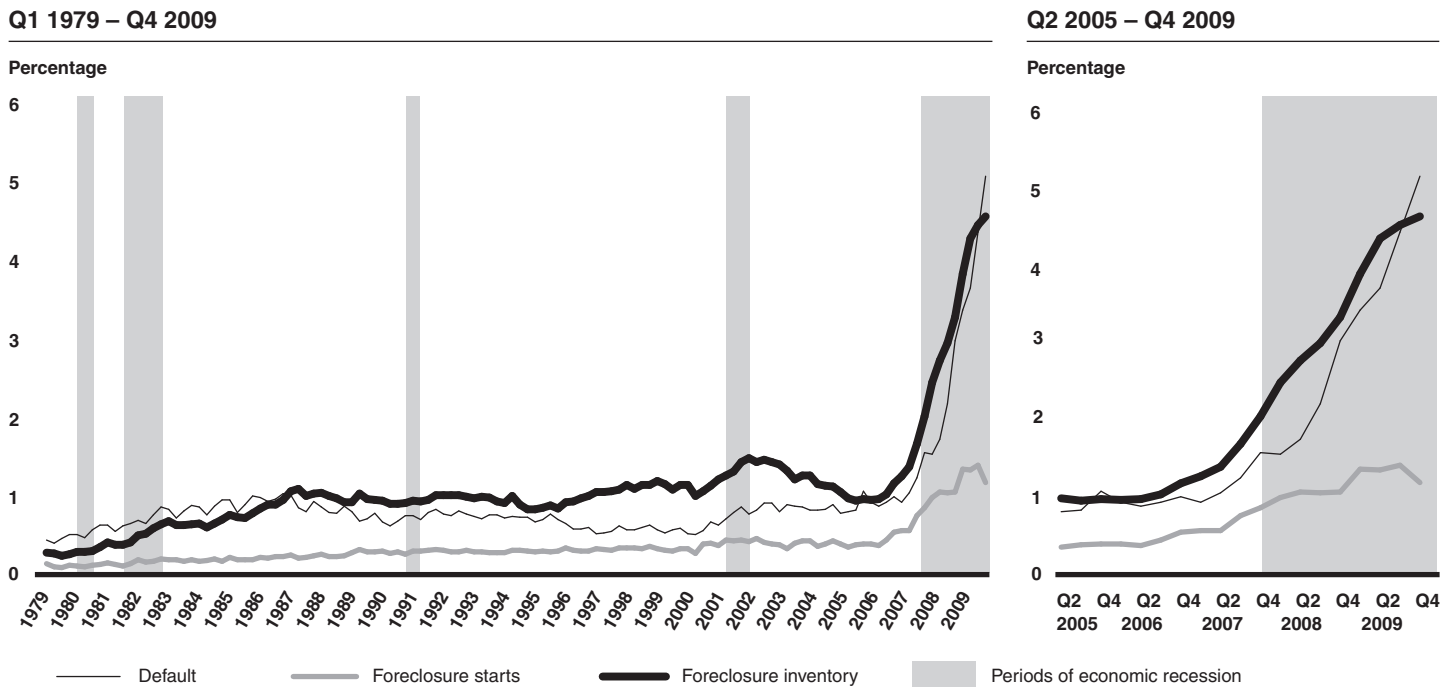
The work on which this testimony is based was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

National default and foreclosure rates rose sharply from 2005 through 2009 to the highest level in 29 years (fig. 1). Default rates climbed from 1.09 percent to 5.09 percent, and foreclosure start rates—representing the percentage of loans that entered the foreclosure process each quarter—grew almost threefold, from 0.42 percent to 1.2 percent. Put another way, over half a million mortgages entered the foreclosure process in the fourth quarter of 2009, compared with about 174,000 in the fourth quarter of 2005. Finally, foreclosure inventory rates rose over 350 percent over the 4-year period, increasing from 0.99 percent to 4.58 percent, with most of that growth occurring after the second quarter of 2007. As a result, over 2 million loans were in the foreclosure inventory as of the end of 2009. Foreclosure starts declined in the last quarter of 2009, but the number of defaults continued to climb.

**Figure 1: National Default and Foreclosure Trends, 1979 – 2009**



Source: GAO analysis of MBA data, National Bureau of Economic Research.

Foreclosure is a legal process that a mortgage lender initiates against a homeowner who has missed a certain number of payments. The foreclosure process has several possible outcomes but generally means that the homeowner loses the property, typically because it is sold to repay the outstanding debt or repossessed by the lender. The foreclosure process is usually governed by state law and varies widely by state. Foreclosure processes generally fall into one of two categories—judicial foreclosures, which proceed through courts, and nonjudicial foreclosures, which do not involve court proceedings. The legal fees, foregone interest, property taxes, repayment of former homeowners’ delinquent obligations, and selling expenses can make foreclosure extremely costly to lenders. Options to avoid foreclosure include forbearance plans, short sales, deeds in lieu of foreclosure, and loan modifications. With forbearance plans and loan modifications, the borrower retains ownership of the property. With short sales and deeds in lieu of foreclosure, the borrower does not.

In March 2009, Treasury issued the first HAMP guidelines for modifying first lien mortgages in an effort to help homeowners avoid foreclosure. The goal of the first-lien mortgage modification program is to reduce the

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monthly payments of struggling homeowners to more affordable levels—specifically 31 percent of household income. According to Treasury, HAMP was intended to offer reduced monthly payments to up to 3 to 4 million homeowners. Under the first-lien modification program, Treasury shares the cost of reducing the borrower’s monthly mortgage payments with mortgage holders/investors and provides various financial incentives to servicers, borrowers, and mortgage holders/investors for loans modified under the program for 5 years. To be eligible for a first-lien loan modification:

- the property must be owner occupied and the borrower’s primary residence;
- the property must be a single-family property (1 to 4 units) with a maximum unpaid principal balance on the unmodified first-lien mortgage that is equal to or less than \$729,750 for a 1-unit property;
- the loan must have been originated on or before January 1, 2009; and
- the monthly first-lien mortgage payment must be more than 31 percent of the homeowner’s gross monthly income.

Borrowers have until December 31, 2012, to be accepted into the first-lien modification program. HAMP also includes other subprograms that, for example, offer incentives to modify or pay off second-lien loans of borrowers whose first mortgages were modified under HAMP and to pursue foreclosure alternatives when a HAMP modification cannot be offered.

The HAMP first-lien modification program has four main features:

1. **Cost sharing** – Mortgage holders/investors will be required to take the first loss in reducing the borrower’s monthly payments to no more than 38 percent of the borrower’s income. Treasury will then use TARP funds to match further reductions on a dollar-for-dollar basis, down to the target of 31 percent of the borrower’s gross monthly income. The modified monthly payment is fixed for 5 years or until the loan is paid off, whichever is earlier, as long as the borrower remains in good standing with the program. After 5 years, the payment may increase by 1 percent a year to a cap of the Freddie Mac rate for 30-year fixed rate loans as of the date that the modification agreement is prepared.

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2. **Standardized net present value (NPV) test** – The NPV test compares expected cash flows from a modified loan to the same loan with no modification. If the expected cash flow with a modification is greater than the expected cash flow without a modification, the loan servicer is required to modify the loan. According to Treasury, the NPV test increases mortgage holder/investor confidence and helps ensure that borrowers are treated consistently under the program by providing a transparent and externally derived objective standard for all loan servicers to follow.
  3. **Standardized waterfall** – Servicers must follow a sequential modification process to reduce payments to 31 percent of gross monthly income. Servicers must first capitalize accrued interest and expenses paid to third parties. Next, interest rates must be reduced to the higher of 2 percent or a level that achieves the 31 percent debt-to-income target. If the debt-to-income ratio is still over 31 percent, servicers must then extend the amortization period of the loan up to 40 years. Finally, if the debt-to-income ratio is still over 31 percent, the servicer must forbear—defer—principal until the payment is reduced to the 31 percent target.<sup>3</sup> Servicers may also forgive mortgage principal at any step of the process to achieve the target monthly payment ratio of 31 percent.
  4. **Incentive payment structure** – Treasury will use HAMP funds to provide both one-time and ongoing (“pay-for-success”) incentives to loan servicers, mortgage holders/investors, and borrowers to increase the likelihood that the program will produce successful modifications over the long term and help cover the servicers’ and investors’ costs of modifying a loan.

Prior to HAMP, many servicers offered their own loan modification programs, but the vast majority of these loan modifications increased or did not change the borrower’s monthly mortgage payment. Rather, the focus of these programs was on bringing delinquent loans current by adding past due interest, advances for taxes or insurance, and other fees to the loan balance. Some of these loan modifications changed the interest rate or remaining term of the loan but typically focused on reducing

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<sup>3</sup>The principal forbearance amount is non-interest bearing and non-amortizing and cannot accrue interest under the guidelines or be amortized over the loan term. Rather, the amount of principal forbearance will result in a balloon payment fully due and payable upon the borrower’s transfer of the property, payoff of the interest bearing unpaid principal balance, or maturity of the mortgage loan.

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payments to 38 rather than 31 percent of the borrower's gross monthly income. For example, FDIC's IndyMac Federal Bank loan modification program, on which HAMP is partially based, initially reduced payments to 38 percent of the borrower's gross monthly income before subsequently revising the payment target to 31 percent. Many servicers continue to offer non-HAMP loan modifications for borrowers who do not qualify for HAMP. Appendix I provides examples of non-HAMP loan modification programs and an overview of other federal foreclosure prevention programs.

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## The HAMP Loan Modification Program Has Made Limited Progress to Date

Treasury first announced HAMP in February 2009 and issued the first implementation guidelines in March 2009. Since then, Treasury has issued 11 supplemental directives for the HAMP program, 8 of them for the first-lien modification program (fig. 2). The early supplemental directives tended to focus on basic implementation issues, but the later directives resulted in significant changes to the program—for example, requiring servicers to send written denial notices to borrowers, streamlining the process used by servicers for evaluating borrowers, and requiring that servicers verify borrowers' income before initiating trial modifications.

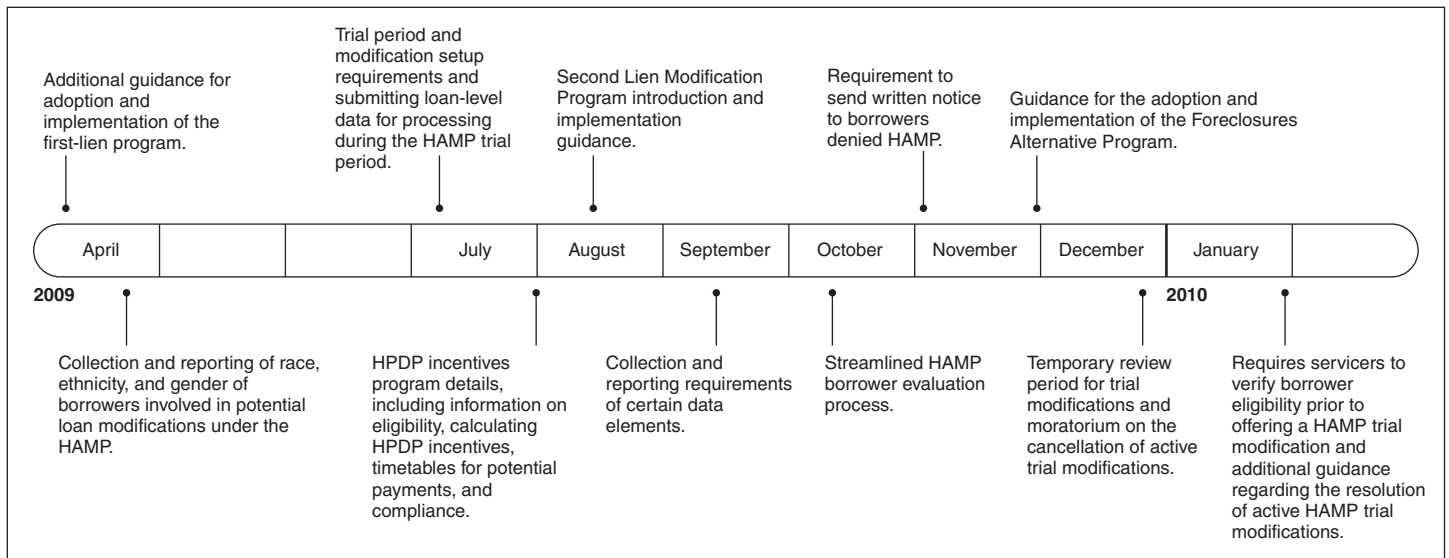
As of March 9, 2010, 113 servicers had signed HAMP Servicer Participation Agreements to modify loans not owned or guaranteed by the government sponsored enterprises (GSE) Fannie Mae and Freddie Mac.<sup>4</sup> Roughly \$36.9 billion in TARP funds have been allocated to these servicers for modification of non-GSE loans. These servicers include national financial institutions such as Bank of America, Wells Fargo, and JP Morgan Chase and national servicing organizations such as GMAC Mortgage and Ocwen. Fannie Mae and Freddie Mac required all servicers of loans that they owned or guaranteed to participate in the GSE HAMP program.

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<sup>4</sup>Under HAMP, Fannie Mae and Freddie Mac are expected to provide up to \$25 billion in funding to encourage servicers to modify loans owned or guaranteed by the two GSEs. According to Treasury, up to \$50 billion in TARP funds will be used primarily to encourage the modification of mortgages that financial institutions own and hold in their own portfolios and mortgages held in private-label securitization trusts (non-GSE loans).



**Figure 2: Timeline of HAMP Program Announcements**



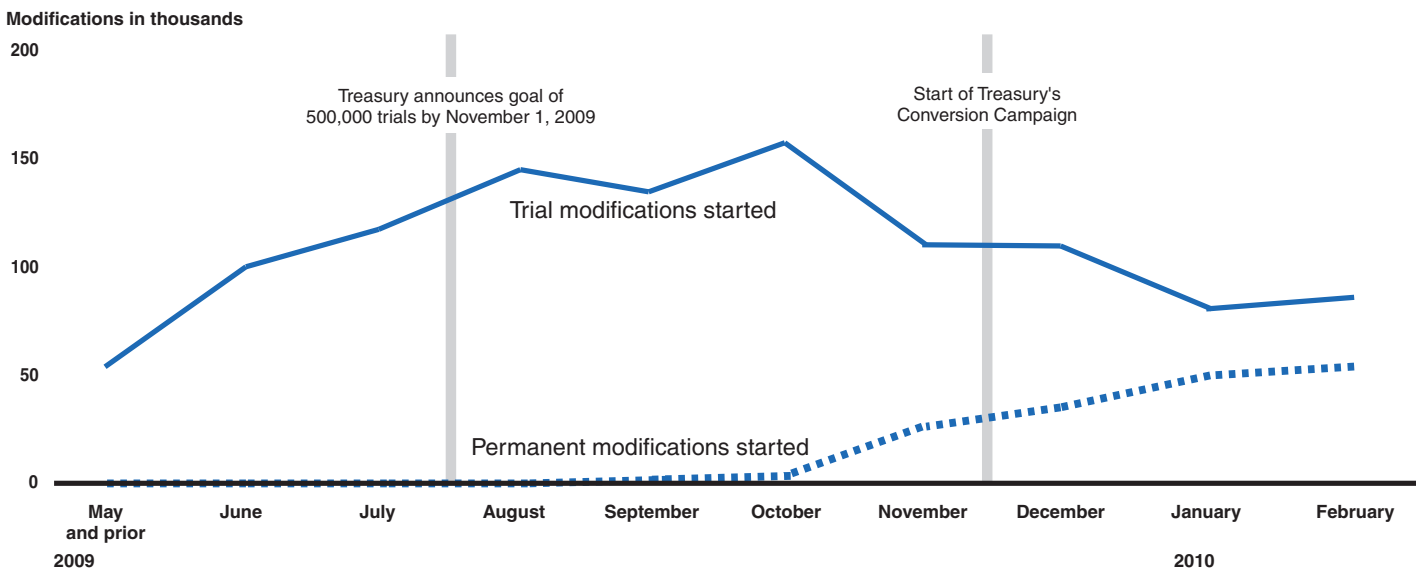
Source: Treasury.

Treasury reported that through February 2010 servicers had offered nearly 1.4 million HAMP trial modifications to borrowers of GSE and non-GSE loans, and roughly 1.1 million of these had begun HAMP trial modifications.<sup>5</sup> Of the trial modifications begun, about 0.8 million were in active trial modifications, fewer than 0.2 million were in active permanent modifications, and the remaining had been canceled. As shown in figure 3, the number of trial modifications started generally increased until October 2009 but then decreased. In part, the decrease in new trial modifications may be the result of a shift in focus on the part of Treasury and the servicers from starting new modifications to making existing trial modifications permanent. In July 2009, Treasury announced a goal of 500,000 trial modifications started by November 1, 2009. In November, however, Treasury announced a campaign to increase the number of conversions to permanent modifications. Although the first trial modifications started nearly a year ago, servicers are completing permanent modifications at a rate slower than Treasury expected, with 32 percent of loans that have been in trial for 3 months or more approved for

<sup>5</sup>Roughly 43 percent of borrowers who were either in trial or permanent modifications as of February 17, 2010, had non-GSE loans and therefore fell under the TARP-funded portion of HAMP.

conversion. Servicers we spoke with cited several challenges in making trial modifications permanent, including obtaining all the required documentation and borrowers who missed trial period payments.

**Figure 3: GSE and non-GSE HAMP Trial and Permanent Modifications Made Each Month**



Source: Cumulative figures taken from January 2010 HAMP Servicer Performance Report, monthly figures are GAO calculated using cumulative figures.

To date, Treasury has reported limited information on the number of borrowers who have been denied trial modifications under HAMP. The 10 HAMP servicers that we spoke with reported a wide range of denial rates. The reasons for denying trial modifications varied by servicer—for example, one servicer reported high proportions of investors prohibiting HAMP modifications and another servicer reported insufficient or excessive borrower income as the most common reasons for denial.

Additionally, Treasury has provided limited data on the performance of HAMP modifications, both trial and permanent. According to program administrators, servicers are not required to report trial period payments on a monthly basis, and these payments may not be reported until the trial modification becomes official. Thus, it is difficult to determine the number of borrowers in trial modifications who may be delinquent in their trial payments. Limited information is available on the performance of permanent modifications because few trials have become permanent. According to Treasury, through the end of February 2010, 1,473 of the

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170,207 permanent modifications made had defaulted, and 26 had paid off their loans.

HAMP payments are contingent upon trial modifications becoming permanent, and given the small number of permanent modifications to date, Treasury has made relatively few incentive payments to investors, servicers, and borrowers. According to Treasury, through the end of February 2010, a total of \$58 million had been disbursed to servicers and investors. Roughly 78 percent of these payments went to servicers and 22 percent to investors. As of March 1, 2010, no incentive payments had been made on borrowers' behalf because no borrowers had reached the first anniversary of their trial modification, as the program requires before making the incentive payment.

Overall, non-GSE borrowers participating in HAMP had their mortgage interest rates on their loans reduced by approximately 5.5 percentage points (from 7.5 percent to 2.0 percent on average) and for nearly half of these borrowers had seen their loan terms extended to 40 years (an increase of 13 years beyond the original remaining term of the loan). To show the payments that Treasury might make for a typical modification, we developed an example of first-lien cost-sharing and incentive payments based on median loan and borrower characteristics of non-GSE borrowers entering trial modifications through February 17, 2010. For a borrower with a loan of about \$222,000 who is paying 44 percent of his gross monthly income toward monthly housing payments, a HAMP modification would reduce the monthly housing payment by \$520, from \$1,760 to \$1,240. Excluding the Home Price Decline Protection (HPDP) incentive, over 5 years Treasury would pay an investor \$9,900 for the difference in mortgage payments and other incentives.<sup>6</sup> A servicer would receive \$4,500, and a borrower \$5,000. In total, the borrower would receive \$36,200 in the form of reduced payments and incentives. Appendix II elaborates on this example.

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<sup>6</sup>The HPDP initiative provides investors with additional incentives for HAMP modifications of loans on properties located in areas where home prices have recently declined and where investors are concerned that price declines may persist. Depending on the location of the home and when the trial modification started, investors may also be eligible to receive up to \$16,200 in HPDP incentives.

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## Further Actions Needed by Treasury to Improve HAMP's Transparency and Accountability

In our July 2009 report on HAMP, we noted that Treasury's projection that 3 to 4 million borrowers could be offered loan modifications was based on several uncertain assumptions and might be overly optimistic. Specifically, we reported that some of the key assumptions and calculations regarding the number of borrowers whose loans would be successfully modified under HAMP using TARP funds were necessarily based on limited analyses and data. According to Treasury, projections for the number of non-GSE borrowers who will participate in HAMP are updated quarterly through the revised allocation of TARP funds for HAMP servicers. Nonetheless, according to Treasury's Web site, Treasury continues to expect that HAMP will offer reduced monthly payments to up to 3 to 4 million borrowers.

We also reported that while HAMP is the cornerstone effort under TARP to meet the act's goals of preserving homeownership and protecting home values, a number of HAMP programs remained largely undefined. Since that time, additional details of the HPDP incentives, second-lien modification program, and foreclosure alternatives program have been announced, but the number of homeowners who can be helped under these programs remains unclear. In July, we noted that Treasury had not estimated the number of additional modifications that would be made as a result of HPDP incentive payments, even though the potential exists for the incentive payments to use up to \$10 billion in TARP funds. To date, Treasury has not prepared any such estimate. In addition, while Treasury has attempted to improve the targeting of these incentive payments by incorporating the size of the unpaid principal balance and the loan-to-value ratio in the payment calculations, HPDP incentives continue to be available for loans that would have passed the NPV test without them. Similarly, although the second-lien and foreclosure alternatives programs were included in the March 2009 program guidelines, no funds have yet been disbursed under either of these programs to date. According to Treasury, as of March 1—over a year after the first announcement of HAMP—details of the second-lien program had not yet been finalized, and only two servicers had signed an agreement to participate in the program.

Finally, we reported in July that Treasury had not finalized a comprehensive system of internal control for HAMP. We noted that important parts of a comprehensive system of internal control include, among other things, implementing a system for determining compliance, having sufficient numbers of staffing with the right skills, and establishing

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and reviewing performance measures and indicators.<sup>7</sup> According to Treasury, it was working with its financial agents to implement such a system and we continue to assess Treasury's efforts in this area.<sup>8</sup> While the Chief of the Homeownership Preservation Office (HPO)—the office within Treasury that is responsible for administering HAMP—consulted with staff and reduced staffing levels from 36 to 29 full-time positions, Treasury has not yet formally assessed whether HPO has staff with the skills needed to govern the program effectively. In addition, Treasury has not yet finalized remedies, or penalties, for servicers who are not in compliance with HAMP guidelines. According to Treasury, these remedies will be complete in April 2010 and a HAMP compliance committee has been established to review issues related to servicers' compliance with program guidelines and to enforce appropriate remedies. Furthermore, while Treasury has put in place some performance metrics for HAMP, it has not developed benchmarks, or goals, to measure these metrics against, limiting its ability to determine the success of the program. We continue to assess Treasury's efforts to establish a comprehensive system of internal control as part of our ongoing oversight of the implementation of TARP and our annual audit of TARP's financial statements. Appendix III provides more detail on the recommendations we made in July and Treasury's responses to them.

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## Servicers Reported Facing Challenges in Implementing HAMP, and Program Implementation Was Sometimes Inconsistent

The servicers we interviewed told us that a major challenge they faced in implementing the HAMP first-lien modification program was the number of changes to the program. Each major program change often required servicers to adjust their business practices, update their systems, and retrain their servicing staff. An example of a significant program change that servicers brought to our attention was Treasury's recent requirement that borrowers fully document their income before they can be evaluated for a trial modification. According to servicers we contacted, Treasury told servicers in July 2009 that it was a "best practice" to use stated income information to evaluate borrowers for trial modifications in order to offer modifications more quickly. As a result, some servicers that had been requiring fully documented income before offering a trial modification switched to using stated income, a change that involved altering business processes, including updating company policies and retraining employees.

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<sup>7</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

<sup>8</sup>Fannie Mae and Freddie Mac are financial agents for the non-GSE portion of HAMP, with Fannie Mae as the program administrator, and Freddie Mac as the compliance agent.

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However, as Treasury became concerned about the number of trial modifications that were not converting to permanent modifications due to difficulty obtaining income documentation from borrowers after the trial period began, Treasury subsequently reversed the policy. In January 2010, Treasury announced that effective June 1, 2010, servicers would be required to evaluate borrowers for trial modifications based on fully documented income. Servicers that switched to or had been using stated income will again have to alter their processes and policies to meet the new standards.

Servicers also told us that the instability of Treasury's NPV model presented another implementation challenge. Although the NPV test is a key element in evaluating borrowers for HAMP, servicers told us that they experienced problems accessing and using the NPV model on Treasury's Web portal. According to Treasury, servicers were allowed to use their own NPV models until September 1, but some servicers told us that the lack of a Treasury model made it difficult for them to begin offering trial modifications. One servicer told us that in the first few months of the program, it was otherwise ready to start making trial modifications but it was unable to effectively use Treasury's Web-based NPV model. As a result, it had to keep borrower applications on hold for several months.

In addition, although one of HAMP's goals is to create clear, consistent, and uniform guidance for loan modifications across the industry, we found inconsistencies and wide variations among the HAMP servicers that we contacted with respect to communication with borrowers about HAMP, the criteria used to evaluate borrowers for imminent default, and the tracking of HAMP complaints.

- **Communications with borrowers** – Although Treasury guidelines state that servicers must provide borrowers with information designed to help them understand the modification process and must respond to HAMP inquiries in a timely and appropriate manner, the HAMP servicers we contacted differed widely in the timeliness and content of their initial communications with borrowers about HAMP. For example, while some servicers contacted borrowers about HAMP as soon as payment was 30 days delinquent, other servicers did not inform borrowers about HAMP until payments were at least 60 days delinquent. Treasury has not developed standards to evaluate servicers' performance in communicating with borrowers or penalties for servicers that do not meet Treasury's requirements.

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We reviewed the Web sites of the 20 HAMP servicers with the largest program allocations and found that 3 did not provide any information about HAMP and that 3 others had posted inaccurate information about the program. The inaccuracies included statements implying that the program had not yet started and that only loans owned by Fannie Mae or Freddie Mac were eligible for HAMP. After we notified Treasury of these issues, two of the servicers updated their Web sites to include accurate program information. However, one continued to contain inaccurate information, and three continued to have minimal information about the program, but, according to Treasury, the level of information cannot be mandated.

- **Criteria for imminent default** – According to HAMP guidelines, borrowers in danger of imminently defaulting on their mortgages may be eligible for HAMP modifications. Although Treasury’s goal is to create uniform guidance for loan modifications across the industry, Treasury has not provided specific guidance on how to evaluate non-GSE borrowers for imminent default, leading to inconsistent practices among servicers. Among the 10 servicers we contacted, there were 7 different sets of criteria for determining imminent default. While some servicers do not impose any requirements beyond the basic HAMP eligibility criteria, others do. For example, four servicers aligned their imminent default criteria for their non-GSE portfolios with the imminent default criteria that the GSEs required for their loans prior to March 1, 2010. These criteria required borrowers to have cash reserves equal to less than 3 months’ worth of monthly housing payments and a ratio of disposable net income to monthly housing payments (debt coverage ratio) of less than 1.20. One servicer had begun using the new GSE criteria for its non-GSE loans, which impose a maximum cash reserves limit of \$25,000 and have no debt coverage ratio requirement, for its non-GSE loans.<sup>9</sup> In addition, four servicers implemented additional criteria for imminent default:
  - including a sliding scale for the borrower’s front-end debt-to-income ratio (e.g., borrowers in the highest income category had to have a front-end debt-to-income ratio of at least 40 percent);
  - an increase in expenses or decrease in income that is more than a certain percentage of income;

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<sup>9</sup>The new GSE imminent default criteria also requires the use of an Imminent Default Indicator™, a statistical model that predicts the likelihood of default or serious delinquency for mortgage loans that are less than 60 days delinquent. However, this indicator is not available for non-GSE loans.

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- a ratio of the remaining loan balance to the current house value that is above a certain percentage; and
  - a “hardship” situation lasting more than 12 months.

As a result of the differences in criteria used to assess imminent default, borrowers with the same financial situation and loan terms could be approved for a HAMP loan modification by one servicer and denied by another.

- **Tracking of HAMP complaints** – While Treasury has directed HAMP servicers to have procedures and systems in place to respond to HAMP inquiries and complaints and to ensure fair and timely resolutions, some servicers are not systematically tracking HAMP complaints or their resolutions. For example, according to Treasury a compliance review conducted by Freddie Mac in fall 2009 cited a servicer for not tracking, monitoring, or reporting HAMP-specific complaints. In the absence of an effective tracking system, the compliance agent could not determine whether the complaints had been resolved. Similarly, several of the servicers we interviewed indicated that they tracked resolutions only to certain types of complaints. For example, several servicers told us that they tracked only written HAMP complaints and that they handled these written complaints differently depending on the addressee. In one case, letters that were addressed to the president of the company were directed to an “escalation team” that tracked the resolution of the complaint, and required weekly updates to the borrower until the complaint was resolved. In comparison, complaint letters that were not addressed to a company executive were routed through a business unit without specific response time requirements.

We have shared our preliminary observations about inconsistencies in servicers’ implementation of HAMP with Treasury so that these inconsistencies can be addressed in a timely manner. As we continue our work evaluating servicers’ implementation of the program, we plan to develop specific recommendations for Treasury as they are needed and appropriate to ensure that HAMP borrowers are treated consistently.

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## HAMP Faces Additional Challenges Going Forward

While HAMP has offered some relief to over a million borrowers struggling to make their mortgage payments, the program may face several additional challenges going forward. These include problems converting trial to permanent modifications, the growing issue of negative equity, redefaults



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among borrowers with modifications, and program stability and management.

- **Conversions** – Treasury has taken some steps to address the challenge of converting trial modifications to permanent modifications, but conversions may continue to be an issue. During December 2009 and January 2010, Treasury held a HAMP Conversion Campaign to help borrowers who were in HAMP trial modifications convert to permanent modifications. This effort included a temporary review period lasting through January 31, which did not allow canceling trial modifications for any reason other than failure to meet HAMP property requirements and a requirement that the eight largest servicers submit conversion action plans. Since the announcement of the Conversion Campaign, the number of new conversions each month has increased from roughly 26,000 in November to roughly 35,000 in December and nearly 50,000 in January. However, as noted above, relatively few trial modifications have been made permanent.
- **Negative Equity** – As we reported in July 2009, HAMP may not address the growing number of foreclosures among borrowers with negative equity in their homes (so-called “underwater” borrowers).<sup>10</sup> While HAMP’s overriding policy objective is to make mortgages more affordable for struggling homeowners, factors other than affordability may influence a borrower’s decision to default, including the degree to which the borrower is underwater. As we reported in July, many states with high foreclosure rates also have high proportions of mortgages with negative equity. To help address this issue, in February 2010 Treasury announced the Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets program, which will allocate \$1.5 billion in HAMP funds to five states that have suffered an average home price drop of at least 20 percent from the state’s price peak, based on a seasonally adjusted home price index. However, the details of this program and the extent to which it will be able to address defaults and foreclosures among this group of borrowers still remain to be seen.
- **Redefaults** – Some borrowers who receive a permanent HAMP modification are likely to redefault on their modified mortgages. Because few permanent modifications have been made to date, the redefault rate for HAMP remains to be seen, but HAMP alone may not address the needs of all borrowers. In particular, while HAMP lowers borrowers’ monthly

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<sup>10</sup>[GAO-09-837](#).

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first-lien payments to 31 percent of their gross monthly income, some borrowers may have high amounts of other debt, such as monthly payments on second mortgages or cars. These borrowers may have difficulty making even modified payments. In our July report, we noted that while Treasury requires borrowers with high levels of total debt to agree to obtain counseling, Treasury was not tracking whether borrowers obtain this counseling. We therefore recommended that Treasury consider methods of monitoring whether or not borrowers were obtaining the required counseling. Treasury officials told us that they considered methods of monitoring compliance but concluded that the processes would be too burdensome. As a result, it remains difficult to determine whether this program feature is likely to meet its purpose of reducing redefaults among high debt-burdened borrowers. We continue to believe that Treasury should seek cost-efficient methods to assess the extent to which the counseling requirement is reducing redefaults. Furthermore, the second-lien program, which could help reduce borrowers' total debt, has yet to be fully specified and, to date, only two servicers have signed up for this program.

- **Program Stability and Management** – HAMP continues to undergo significant program changes, including the recently announced shift to upfront income verification and the implementation of the second-lien modification program, the foreclosure alternatives program, and the Hardest-Hit Housing Markets program. Treasury will be challenged to successfully implement these programs while also continuing to put in place the controls and resources needed to continue the first-lien modification program.

Given the magnitude of the investment of public funds in HAMP and the fact that the program represents direct outlays of taxpayer dollars rather than investments that may yield a return (as in other TARP programs), it is imperative that Treasury continue to improve HAMP's transparency and accountability. As we have noted, HAMP is Treasury's cornerstone effort under TARP to meet the act's purposes of preserving homeownership and protecting home values. As the number of delinquent loans and foreclosures continues to climb and home values continue to fall in many areas of the country, Treasury will need to ensure that borrowers receive consistent access to and treatment from servicers. Treasury also needs to make sure that it has the information, controls, and resources to successfully implement a still-developing program. We will continue to evaluate the implementation of HAMP as part of our ongoing oversight of the activities and performance of TARP.

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Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss this critically important program and would be happy to answer any questions that you may have. Thank you.

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## Contact

For further information on this testimony, please contact Richard J. Hillman at (202) 512-8678 or [hillmanr@gao.gov](mailto:hillmanr@gao.gov), Thomas J. McCool at (202) 512-2642 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov), or Mathew J. Scirè at (202) 512-8678 or [sciremj@gao.gov](mailto:sciremj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made major contributions to this statement are listed in appendix IV.

# Appendix I: Examples of Other Foreclosure Prevention Programs

Institution	Program or effort	Selected program characteristics
GSEs (Fannie Mae and Freddie Mac)	Home Affordable Refinance Program	<ul style="list-style-type: none"> <li>Borrowers with loans owned or guaranteed by Fannie Mae or Freddie Mac can refinance into a fixed rate loan at the current market rate</li> <li>Eligible borrowers are current on their loans, the owner occupant of a one- to four-unit property, and have a loan-to-value ratio (LTV) of less than 125 percent</li> <li>Between February 2009 and February 2010, over 190,000 borrowers were refinanced through HARP</li> </ul>
Federal Housing Administration (FHA)	Hope for Homeowners	<ul style="list-style-type: none"> <li>Borrowers can refinance into an affordable loan insured by FHA</li> <li>Eligible borrowers are those who, among other factors, have a monthly mortgage debt-to-income ratio above 31 percent</li> <li>Servicers provided incentive payments; lenders required to write down the existing mortgage amount depending on the borrower's monthly mortgage debt-to-income ratio and total household debt.</li> <li>Borrowers must agree to share the equity created at the beginning of their new Hope for Homeowners mortgage</li> <li>Between October 2008 and January 2010, 96 loans were refinanced under Hope for Homeowners</li> </ul>
Federal Deposit Insurance Corporation	IndyMac Loan Modification Program	<ul style="list-style-type: none"> <li>Eligible borrowers can get monthly mortgage payments reduced to 31 percent of gross monthly income.</li> </ul>
Private-sector financial institutions	Private-sector foreclosure prevention programs	<ul style="list-style-type: none"> <li>Programs vary, but include modification programs aimed at reducing monthly payments.</li> <li>For example, one bank has a program to modify pay option adjustable rate mortgages. Another bank modifies loans to decrease monthly payments to between 31 and 40 percent of the borrower's monthly gross income.</li> </ul>

Source: Publicly available information from agencies and organizations listed above.

# Appendix II: Example of Treasury Payments for a Typical Modification over 5 Years

	Monthly loan payment	Debt to income ratio	Loan to value ratio	Term (months)	Interest rate (fixed)	Total unpaid balance	Notes
Loan origination	\$1,760	44%	90%	360	7.5%	\$222,000	House value of \$246,667.
Two years later (borrower 60 days delinquent)	\$1,760	44%	114%	338	7.5%	\$225,194	House value decreases 20%.
Loan modification	\$1,240	31%	114%	480	2.0%	\$225,194	Reduction in payment of 30%.

\$520 monthly payment reduction (Treasury pays \$140; Investor forgoes \$380)

First five years after loan modification				
Treasury payments		Incentive recipients		
		Investor	Servicer	Borrower
Payment for Monthly Reduction (from 38% to 31%)	\$8,400			
Servicer Incentive			\$1,000	
Current Borrower Bonus	1,500		500	
Pay for Performance Success (\$1,000/yr for 5 yrs)				\$5,000
Pay for Success (\$1,000/yr for 3 yrs)			3,000	
Home Price Decline Protection (HPDP)			<sup>a</sup>	
<b>Total</b>	<b>\$9,900<sup>a</sup></b>	<b>\$4,500</b>	<b>\$5,000</b>	

Borrower benefits		
Pay for Performance Success (\$1,000/yr for 5 yrs)		\$5,000
Treasury Payments on Behalf of Borrower for Monthly Payment Reduction	8,400	
Investor Payments on Behalf of Borrower for Monthly Payment Reduction	22,800	
<b>Total</b>		<b>\$36,200</b>

Source: GAO.

<sup>a</sup>Investors may also be eligible to receive HPDP incentive payments depending on where the property is located. For this example, if the trial modification were started in September 2009, investors may be eligible for HPDP incentives that range from \$0 to \$16,200. If the trial started during October, November, and December 2009, the amounts could range from \$0 to \$10,800. If the trial started during the first 3 months of 2010, the incentive payment could be as much as \$5,880.

# Appendix III: Treasury's Actions in Response to GAO's July 2009 HAMP Recommendations

GAO recommendation	Treasury actions to date
<p>Consider methods of monitoring whether borrowers with total household debt of more than 55 percent of their income who have been told that they must obtain HUD-approved housing counseling do so, and assessing how this counseling affects the performance of modified loans to see if the requirement is having its intended effect of limiting redefaults.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, it considered options for monitoring what proportion of borrowers is obtaining counseling, but determined that it would be too burdensome to implement.</li> <li>• Treasury does not plan to assess the effectiveness of counseling in limiting redefaults because it believes that the benefits of counseling on the performance of loan modifications is well documented and the assessment of the benefits to HAMP borrowers is not needed.</li> </ul>
<p>Reevaluate the basis and design of the HPDP program to ensure that HAMP funds are being used efficiently to maximize the number of borrowers who are helped under HAMP and to maximize overall benefits of utilizing taxpayer dollars.</p>	<ul style="list-style-type: none"> <li>• On July 31, 2009, Treasury announced detailed guidance on HPDP that included changes to the program's design that, according to Treasury, improve the targeting of incentive payments to mortgages that are at greater risk because of home price declines.</li> <li>• Treasury does not plan to limit HPDP incentives to modifications that would otherwise not be made without the incentives, due to concerns about potential manipulation of inputs by servicers to maximize incentive payments and the additional burden of re-running the NPV test for many loans.</li> </ul>
<p>Institute a system to routinely review and update key assumptions and projections about the housing market and the behavior of mortgage-holders, borrowers, and servicers that underlie Treasury's projection of the number of borrowers whose loans are likely to be modified under HAMP and revise the projection as necessary in order to assess the program's effectiveness and structure.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, on a quarterly basis it is updating its projections on the number of non-GSE first-lien modifications expected when it revises the amount of TARP funds allocated to each servicer under HAMP.</li> <li>• Treasury is gathering data on servicer performance in HAMP and housing market conditions in order to improve and build upon the assumptions underlying its projections about mortgage market behavior.</li> </ul>
<p>Place a high priority on fully staffing vacant positions in the Homeownership Preservation Office (HPO)—including filling the position of Chief Homeownership Preservation Officer with a permanent placement—and evaluate HPO's staffing levels and competencies to determine whether they are sufficient and appropriate to effectively fulfill its HAMP governance responsibilities.</p>	<ul style="list-style-type: none"> <li>• A permanent Chief Homeownership Preservation Officer was hired on November 9, 2009.</li> <li>• According to Treasury, staffing levels for HPO have been revised from 36 full-time equivalent positions to 29.</li> <li>• According to Treasury, as of March 2010, HPO had filled 27 of the total of 29 full-time positions.</li> </ul>
<p>Expediently finalize a comprehensive system of internal control over HAMP, including policies, procedures, and guidance for program activities, to ensure that the interests of both the government and taxpayer are protected and that the program objectives and requirements are being met once loan modifications and incentive payments begin.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, it will work with Fannie Mae and Freddie Mac to build and refine the internal controls within these financial agents' operations as new program components are implemented.</li> <li>• Treasury expects to finalize a list of remedies for servicers not in compliance with HAMP guidelines by April 2010.</li> </ul>
<p>Expediently develop a means of systematically assessing servicers' capacity to meet program requirements during program admission so that Treasury can understand and address any risks associated with individual servicers' abilities to fulfill program requirements, including those related to data reporting and collection.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, a servicer self-evaluation form, which provides information on the servicer's capacity to implement HAMP, has been implemented beginning with servicers who started signing Servicer Participation Agreements in December 2009.</li> </ul>

Source: GAO and analysis of Treasury information.

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# Appendix IV: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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