NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
John Taylor, President and CEO
National Community Reinvestment Coalition

On the topic
"The Impact and Execution of the Department of Treasury's Foreclosure Prevention Efforts and the Home Affordable Modification Program (HAMP)"

Submitted to the
United States House of Representatives
Committee on Oversight and Government Reform

Thursday, March 25, 2010

National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

I. Introduction

Good morning, Chairman Towns, Ranking Member Issa, and other distinguished members of the Committee. My name is John Taylor and I serve as President and CEO of the National Community Reinvestment Coalition (NCRC). I am honored to testify today before the House Committee on Oversight and Government Reform on behalf of NCRC on the topic of impact of the Administration's foreclosure prevention program and suggestions for improvement.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

Our country faces a foreclosure and economic crisis, dubbed the Great Recession, which is the worst crisis since the Great Depression. It is sadly ironic that this crisis could have been averted or, at the very least, mitigated if Congress and the federal regulatory agencies had increased the rigor of consumer protection and fair lending law and enforcement. A major factor causing this crisis was reckless and irresponsible lending that was not stopped by the regulatory agencies. For instance, the Office of the Comptroller of the Currency facilitated this lending by preempting state law in 2004 and the Federal Reserve Board finally enacted an anti-predatory regulation in the summer of 2008, much too little and too late.

RealtyTrac found that the nation experienced 2.8 million foreclosure filings in 2009, a 21 percent increase from 2008. In its latest report, RealtyTrac finds that the nation suffered foreclosure filings on an additional 308,524 properties in February 2010, which was a 6 percent increase from February 2009. In just February alone, one out of every 418 homeowners received a foreclosure filing.[1] In addition, the Mortgage Bankers

[1] *U.S. Foreclosure Activity Decreases 2 Percent in February*, see http://www.realtytrac.com, March 11, 2010 press release.

Association (MBA) reports that the national delinquency rate was 9.5 percent and the foreclosure rate was 4.6 percent in the fourth quarter of 2009. The combined delinquency and foreclosure rate of about 15 percent was the highest recorded by the MBA survey.[2]

Chairman Towns, NCRC has started a campaign called "Keys from the Crisis" that symbolizes the powerful and devastating impacts of this crisis on families. In this container next to me, NCRC has collected several hundred keys that are from families experiencing foreclosures. We are also collecting stories and pictures from displaced families. NCRC hopes that this imagery motivates policymakers and stakeholders to craft a large scale and effective foreclosure prevention program.

Solving the foreclosure crisis is critical for the economic health of this country. Since the onset of this crisis, $7 trillion in household wealth has been lost.[3] The loss of household wealth translates into reduced consumer spending, depressed business activity, lower gross national product, lower property tax receipts, and higher local and state budget deficits. Foreclosures do not only impact individual homeowners but entire neighborhoods through declining property values, increases in abandonment, decay, crime, and vandalism. In short, the continued failure to adequately address this crisis multiplies the profound social, cultural, and economic injury to our nation.

Since the federal government exacerbated the foreclosure crisis through its inaction, the government has an obligation to play a major role in ending this crisis. My testimony today will describe in detail the origins of the crisis (problematic lending followed by severe unemployment) since understanding the causes of the crisis is critical to designing programs to end the crisis. The experiences of NCRC's Housing Counseling Network will add important insights in the discussion about the accomplishments and shortcomings of the current Administration programs. NCRC also participates in the Coalition of U.S. Department of Housing Counseling Intermediaries which has sent

---

[2] Mortgage Bankers Association, *Delinquencies, Foreclosure Starts Fall in Latest MBA National Delinquency Survey*, February 19, 2010 press release available at http://www.mbaa.org/NewsandMedia/PressCenter/71891.htm.
[3] *The Economy: The Crisis and Response*, a presentation of the San Francisco Federal Reserve Bank, see http://www.frbsf.org/econanswers/crisis.htm?1

letters to Treasury Department officials discussing critical programmatic issues associated with the Administration foreclosure prevention programs.[4]

As part of this testimony NCRC is releasing two reports: *NCRC HAMP Mortgage Modification Survey* and *Foreclosure Prevention Service Providers*. NCRC's *HAMP Mortgage Modification Survey* is the first report of its kind in that NCRC reports on modification outcomes by race, gender, and age of borrower based on a survey administered to 29 nonprofit counseling organizations whose counselors assisted 179 homeowners respond to the questions. The survey reveals a number of troubling trends. For example, only 36.4 percent of white homeowners eligible for the federal Home Affordable Modification Program (HAMP) received a modification at the time of the survey but even fewer (24.3 percent) of African-American homeowners received a modification. Almost 50 percent of the distressed homeowners seeking modifications were 50 and older, suggesting that this crisis has the potential to threaten the retirement security of a large segment of the American population. In addition, non-HAMP eligible homeowners were more likely to receive a modification than HAMP eligible homeowners.

NCRC's *Foreclosure Prevention Service Providers: What Consumers Should Know and Red Flags to Avoid* serves as a sober warning about the perils waiting for desperate borrowers if reputable modification programs are not widely available.[5] In this report, NCRC conducts "mystery shopping" of about 100 foreclosure prevention providers. Guided by NCRC professional staff, the shoppers posed as delinquent borrowers facing steep increases in the monthly payment of their interest-only loans. The foreclosure prevention providers quoted an average fee of $2,611 for their services and only 20 percent followed Federal Trade Commission (FTC) guidance that requires companies to inform consumers of alternatives such as nonprofit organizations that provide foreclosure prevention services for free. In about one fourth of the mystery shopping calls, the

[4] See for example, an October 9, 2009 letter to Treasury Secretary Geithner, HUD Secretary Donovan, and NEC Director Summers that highlights process issues in the HAMP program that are elaborated on in this testimony. Letter on file at NCRC.

[5] The full title is *Foreclosure Prevention Service Providers: What Consumers Should Know and Red Flags to Avoid – A Compliance White Paper based on Client Interviews, Literature Review, and a Comprehensive Fair Lending Audit*

shoppers were advised not to pay their mortgage and not to have any contact with their lender since the foreclosure prevention provider would communicate with the lender. These foreclosure prevention providers were engaged in the exact opposite of their companies' descriptions in that their abusive practices would exacerbate the chances of foreclosure instead of reducing them.

This testimony will outline several recommendations. These recommendations include:

NCRC's HELP Now Proposal: NCRC's HELP Now proposal features bulk purchases of distressed loans at a discount, refinancing these loans by FHA and the Government Sponsored Enterprises (GSEs) into sustainable mortgages, and then the sale of these mortgages back into the private sector. The government's general eminent domain powers and the statutory language establishing the Troubled Asset Relief program (TARP) provides the authority for the approach of the HELP Now proposal. While the goal of the Administration's Home Affordable Modification Program (HAMP) is laudable, the program has not produced the necessary volumes of modifications because it has relied on voluntary industry efforts motivated by federal subsidies.

In 2008, the federal government guaranteed or owned (via the Government-Sponsored Enterprises, which were put in conservatorship that year) almost 70 percent of the mortgages issued that year. For 2009 and 2010, estimates are as high as 86 percent of the mortgages guaranteed or owned by the federal government. In this context, it is hard to understand why there is not more progress under HAMP and the Home Affordable Refinance Program (HARP) since the government could be more forceful in deciding the fate of the distressed loans it controls. It is time, therefore, to consider a mandatory approach which requires the private sector to be expeditious and to exceed the subsidies offered by the American taxpayer to restructure distressed loans into affordable mortgages.

Need for Principal Reductions: Currently, the HAMP program regards principal reductions or forbearance as one of the last modification options. Substantial research

and programmatic experience, however, indicates that significant principal reduction is needed on a large scale, particularly in geographical regions of the country experiencing high levels of negative equity, foreclosures, and nonprime lending. The NCRC Help Now proposal would facilitate principal reduction by requiring financial institutions to sell distressed loans to the federal government at a significant discount.

Establish Loan Program for the Unemployed: H.R. 4173, passed by the House, establishes a $3 billion loan program, modeled after a successful and longstanding Pennsylvania program that provides low-interest loans for unemployed homeowners so that they can continue making loan payments and avoid foreclosure. Last month, the Administration announced a $1.5 billion initiative to be targeted to five states experiencing steep prices declines to establish loan modifications for unemployed homeowners and other distressed homeowners. This proposed funding is a start and will need to be supplemented by additional public and private funding in order to reach adequate scale in the five states and in other states as well.

Process Improvements in HAMP: The Administration must increase fairness and equity in the HAMP program by immediately stopping foreclosure proceedings while borrowers are in the loan modification stage. We are encouraged about media reports indicating that the Treasury Department intends to halt foreclosure proceedings while borrowers are in a trial modification.[6] It is unclear, however, how many other protections are being contemplated by the Treasury Department. For example, will this new policy apply to borrowers being evaluated for trial modifications? In addition, we are pleased that Treasury plans to require consideration of applications from borrowers in bankruptcy. Finally, the Treasury Department must increase the transparency of the Net Present Value (NPV) model that considers eligibility for modifications so that counselors and borrowers can more effectively appeal denials of loan modification requests.

[6] "Obama Mulls Changes to Mortgage Program: More consumer protections may be added to fix long-standing complaints," Associated Press report 3:30 PM, February 22, 2010, accessed via http://www.msnbc.msn.com/id/35525942/ns/business-real_estate/.

Fair Lending Investigation in the HAMP Program and Participating Servicers: NCRC's survey findings of racial disparities in receiving modifications call for a thorough fair lending investigation of the HAMP program and participating servicers. The investigation should assess if the HAMP program guidelines and NPV test contain any elements that have a disparate impact on protected classes that is not justified by business necessity. In addition, do the servicers engage in any practices that result in disparities or, worse, are discriminatory in intent and effect?

Second Liens and Short Sales: Banks own a significant amount of second liens. The regulatory agencies must recognize the reluctance to modify second liens as both a consumer protection/fair lending and a safety and soundness issue. If a high percentage of second liens default, the safety and soundness of the banks are undermined.

Related to the stubbornness of holders of second liens to modify their loans is the short sale program recently announced by the Treasury Department. The short sale program must not become a convenient excuse for not modifying difficult loans, including those with second liens. The short sale program must truly become a last resort for borrowers who cannot afford loans even after modification. Congress and the Treasury Department must monitor the use of short sales carefully to ensure that lenders and servicers do not abuse the short sale program. Also, policymakers must outlaw or limit the use of broker price opinions (BPOs) in conjunction in HAMP's short sale programs. BPOs have been found to destabilize property values by underestimating values in order to facilitate sales.

Larger Role for Nonprofit Organizations: Consider a larger role for nonprofits as borrower advocates, including taking over caseloads for servicers who display continued and gross incompetence in executing loan modifications. Another option is for the Treasury Department, the Government Sponsored Enterprises, or servicers to consider contracting out to nonprofit organizations for the roles of underwriting and arranging for modifications or refinances in the HAMP and HARP programs. While further considering nonprofit roles in foreclosure prevention programs, we also urge the Department of Housing and Urban Development (HUD) to exempt nonprofit counseling

agencies from the requirements of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act). Further registration and fee requirements would overburden nonprofit counseling organizations which already must comply with rigorous HUD certification standards.[7]

Enhance Publicly Available Data on HAMP and HARP: Accountability depends on transparency. The cursory reports on HAMP and HARP must be replaced with detailed data disclosure that provides information on applications and denials for modifications by race, income, and gender of borrower so that the public and private sectors can be effectively held accountable for equitably serving all segments of the population. About a year after HAMP and HARP program implementation, NCRC is releasing a survey today that examines modification experience by demographic characteristics. The government, with vastly greater resources than NCRC, should have conducted such a study much earlier to make sure all communities have equitable access to foreclosure prevention.

Require Loss Mitigation and Bankruptcy Reform: Private sector institutions would be more serious about modifying loans if Congress passed laws requiring reasonable and documented loss mitigation efforts before foreclosure and reformed the bankruptcy laws to allow judges to modify loans for primary residences.

Stop Foreclosure Prevention Scams: NCRC's foreclosure prevention service provider report underscores the need for an effective legislative solution and increased public and private sector oversight combined with effective education and outreach to ensure consumers work with responsible providers. Modification companies are often operating in a regulatory vacuum, without any accountability, and today, may be one of the factors blocking consumer access to the Home Affordable Mortgage Program and the Home Affordable Refinance Program.

---

[7] See February 9 letter from the Coalition of Housing Counseling Intermediaries to HUD regarding Docket No. FR-5271-P-01, on file at NCRC.

Prevent Future Crises: In order to avert future crises, Congress must pass a robust financial regulatory reform bill that modernizes the Community Reinvestment Act (CRA) and expands CRA's coverage to non-bank financial institutions, enacts a comprehensive anti-predatory law, and establishes a strong and independent Consumer Financial Protection Agency (CFPA) with jurisdiction over all consumer protection and fair lending laws, including CRA.

II. Problematic Lending Practices Drive the Foreclosure Crisis

The "originate-to-distribute" model of lending drove the foreclosure crisis. Over the last several years, financial institutions engaged in riskier lending as they realized that they could avoid the financial consequences of such lending by selling loans to investors. Policy makers including Federal Reserve Chairman Ben Bernanke acknowledge that the originate-to-distribute model lead to a loosening of underwriting standards.[8] As a result, borrowers became deeply leveraged in debt. Understanding the characteristics of the problematic loans is the key to designing foreclosure prevention programs. Loans that highly leverage borrowers require deep subsidies or reductions in monthly payments in order for borrowers to resume timely loan payments. Foreclosure prevention programs that feature relatively shallow subsidies from either the public or private sector will not succeed in ameliorating the foreclosure crisis.

Substantial research documents the deterioration in underwriting standards and the increase in reckless lending. The Government Accountability Office (GAO) reports that the Federal Housing Administration (FHA) observes a guideline that loans and other debt should not exceed 41 percent of a borrower's monthly income. The GAO then found that

---

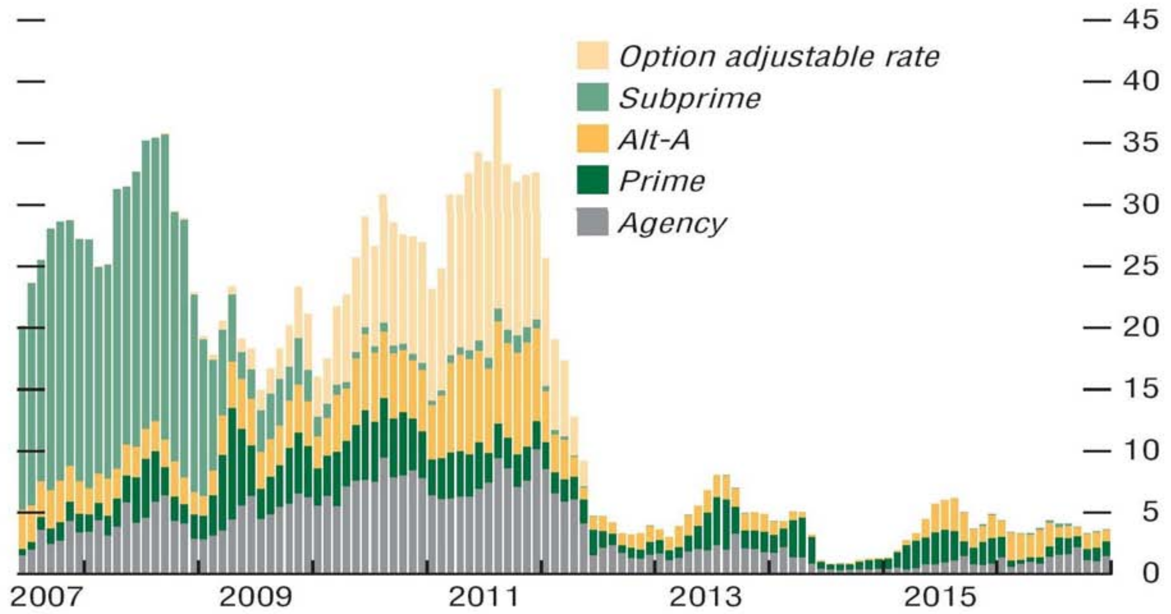
[8] Federal Reserve Chairman Ben S. Bernanke, Speech, *Fostering Sustainable Homeownership* at the National Community Reinvestment Coalition Annual Meeting, Washington, D.C, March 14, 2008, see http://www.federalreserve.gov/newsevents/speech/bernanke20080314a.htm, The Chairman observes, "In this instance, this originate-to-distribute model appears to have contributed to the breakdown in underwriting standards, as lenders often found themselves able to pass on the credit risk without much resistance from the ultimate investors. For a number of years, rapid increases in house prices effectively insulated lenders and investors from the effects of weaker underwriting, providing false comfort."

47 percent of subprime loans exceeded this 41 percent debt-to-income ratio in 2000, but by 2007 this worsened to 59 percent of subprime loans exceeding the benchmark.[9]

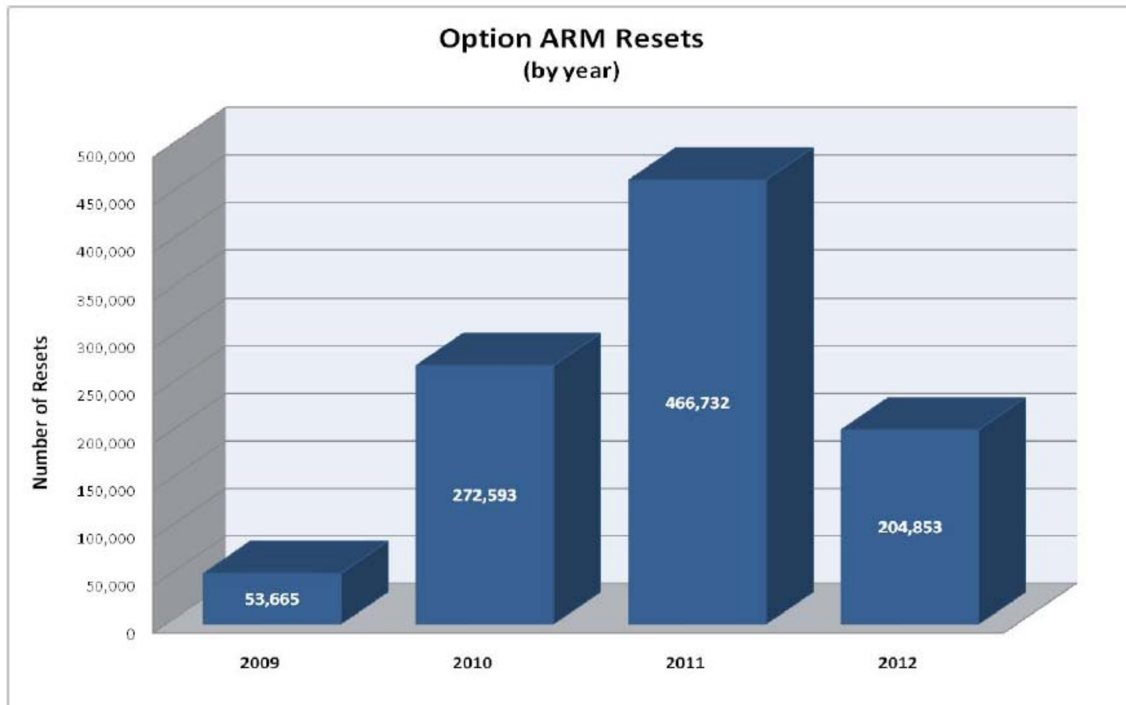
Likewise, the Federal Reserve found that the percentage of subprime loans which did not involve sufficient documentation of borrowers' incomes increased from 20 percent in 2000 to 40 percent in 2006.[10] Similarly, the share of so-called ALT-A loans (that feature reduced documentation of borrower income) which involved high loan-to-value ratios (LTV) of 90 percent or more surged from 2 percent in 1998 to 32 percent in 2006 according to the St. Louis Federal Reserve Bank.[11] High loan-to-value ratio loans contributed to leveraged borrowers being "underwater" or owing more than their house is worth in the wake of significant price declines.

As the following two graphs illustrate, the first wave of problematic loans consisted mostly of subprime loans while the second wave of problematic loans was comprised predominantly of so-called option Adjustable Rate Mortgage (ARM) or "non-traditional" loans. An option ARM loan features payment options that range from paying the principal and interest rate each month to not even paying the entire monthly interest rate. When a borrower chooses the pay the least amount required, the loan negatively amortizes, meaning that the outstanding amount actually increases. This plus the increase in interest rates caused by the ARM feature results in payment shock, or substantial increases in monthly payments that were not usually explained adequately to borrowers. More than 270,000 option ARM loans will have interest rate adjustments or resets this year, and more than 460,000 will have resets in 2011 as shown below. Fitch Ratings finds that the average increase in the monthly payment due to an interest rate reset is an incredible $1,053 or more than 60 percent increase in the monthly payment.[12]

[9] Government Accountability Office, *Characteristics and Performance of Nonprime Mortgages,* report for Joint Economic Committee, July 2009, p. 10, see, http://www.gao.gov/new.items/d09848r.pdf
[10] Federal Reserve System, Truth in Lending: Final Rule, Federal Register, July 30, 2008, Vol. 73, No. 147
[11] Rajdeep Sengupta, *Alt-A: The Forgotten Segment of the Mortgage Market*, Federal Reserve Bank of St. Louis Review, January/February 2010, p. 64, see http://research.stlouisfed.org/publications/review/10/01/Sengupta.pdf
[12] "The Growing Foreclosure Crisis," The Washington Post, January 17, 2009.



Source: Credit Suisse.



Because subprime and non-traditional loans exhibited imprudent underwriting, their delinquency rates are considerably higher than prime loans. According to the OCC and OTS Mortgage Metrics report for the Third Quarter of 2009, the serious delinquency rate for prime, Alt-A, and subprime loans were 3.6 percent, 12 percent, and 20.1 percent, respectively.[13] Other estimates of serious delinquency are even higher. For example, the GAO reports a serious delinquency rate for subprime loans at 31 percent and payment option ARM loans at 33 percent.[14] The GAO further reports that among all active non-prime loans, 13 percent are in the foreclosure process.[15]

Another disturbing aspect of the reckless lending is that this lending was targeted to financially vulnerable communities. NCRC's *Broken Credit System* and other research shows that minority neighborhoods received larger percentages of subprime loans than predominantly white neighborhoods, even after controlling for creditworthiness and other housing stock characteristics.[16] Because minorities are more likely to receive high-cost and non-traditional loans than whites, minorities are more likely to experience foreclosure according to researchers at the Federal Reserve Banks of San Francisco and Boston. Laderman and Reid found that African-American borrowers were 1.8 times more likely than whites to be in foreclosure, whereas Latinos and Asians were 1.4 and 1.3 times more likely to be in foreclosure, respectively than whites after controlling for several loan and borrower characteristics.[17] Likewise Geraldi and Willen document that in Massachusetts, underwriting standards for subprime loans were deteriorating over time, but more so for minorities than whites. The median debt-to-income ratios and loan-

[13] OCC and OTS Mortgage Metrics Report, Third Quarter 2009, December 2009, p. 17 available at http://www.occ.gov/ftp/release/2009-163a.pdf

[14] Government Accountability Office, *Loan Performance and Negative Home Equity in Nonprime Mortgage Market*, report for the Joint Economic Committee, Dec 09, p. 9 available at http://www.gao.gov/new.items/d10146r.pdf

[15] Government Accountability Office, *Loan Performance and Negative Home Equity*, p. 8.

[16] *Broken Credit System* available via NCRC on 202-628-8866. Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov. also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622

[17] Elizabeth Laderman and Carolina Reid, Federal Reserve Bank of San Francisco, "CRA Lending during the Subprime Meltdown in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act," a Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/cra_lending_during_subprime_meltdown.pdf

to-value ratios worsened to a greater extent for African-American and Hispanic borrowers than whites from 1998 through 2006. It follows then that 15 percent of subprime loans originated in 2005 ended in foreclosure by December 2007 for African-Americans, 10 percent for Hispanics, and only 6.5 percent for whites.[18]

To make matters worse, NCRC's HAMP survey reveals that minorities, which were disproportionately subjected to problematic lending, are now experiencing less access to modifications. The survey indicates that 36.4 percent of HAMP-eligible whites received modifications, but only 24.3 percent of African-Americans received modifications. Whites were almost 50 percent more likely to receive a modification. Given that minority communities were targeted by abusive lenders, it would seem that federally-supported modification programs should go to extra lengths to ensure equitable access to modifications for all applicants that qualify.

Case Study of NCRC Housing Counseling's Network Client

The following is a case study told in the client's own words of a problematic loan, followed by a spell of unemployment and then a new lower paid job, which almost cost the family the home. The modification process was difficult but finally, a final modification appears to be in sight.

We purchased the home on December 29, 2006 for $639,940, feeling pressured to settle for a huge mortgage of $450,000 and a mortgage payment of $2,770 each month. The payment has since been raised due to the escrow going up. The only way the lender could get us into the home, based on our income, was to offer us an interest-only loan. Although we had concerns about the market, we had already tied up $62,000 in earnest money deposit and opened a construction loan. Shortly after, the housing market plummeted and continues to fall even three years later.

Well, about a year after we settled, my husband was laid off from his job as a residential home builder. My career also suffered because I work in the real estate industry. We did what we could while my husband searched for jobs daily for the next eight months until he was able to secure another position. We still have not caught up from the reduction in income during those eight months and we continue to go into more debt just trying to keep up with the bills. My husband's new position has the same title and responsibilities but he is earning $30,000 less in income each year.

[18] Kristopher S. Geraldi and Paul Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods,* Public Policy Discussion Papers, Federal Reserve of Boston, No. 08-06, December 22, 2008.

We knew we could not keep up with payments because we kept getting into more debt. In January 2009, we requested assistance from the mortgage company, but the process was a nightmare. After submitting the initial package that included all the documents, we had to resend the same documents on three different occasions. I finally got to the point where the situation was too overwhelming and I needed help.

In August of 2009, after many months of confusion and frustration, I reached out to a HUD Counseling Agency located close by in Washington DC, and was then quickly contacted by NCRC. After talking with NCRC, we got results in just over a month. NCRC was able to get my mortgage into the Making Home Affordable Loan Modification Program.

We received a trial modification in the middle of November 2009, and the first of our three trial payments began on December 20, 2009. The new payment has taken a huge financial burden off of me and my family. Our new payments are $2,006.51 which is a $796.04 monthly savings. Most importantly, our new payment includes principal and is on a fixed term. Our previous mortgage was interest only and would adjust upward.

We have just made our last trial payment and hope to receive our final modification soon. After months of hardship, we are close to getting back to normal without the cloud hanging over our head.

III. Unemployment and the Foreclosure Crisis

The foreclosure crisis has contributed to the highest unemployment rates in the last quarter center.[19] The slump in the lending, housing, and construction industries directly contributed to layoffs. In a vicious cycle, the record rates of unemployment are now feeding continued foreclosures. The Bureau of Labor Statistics reports that for January of 2010, 9.7 percent of American workers are unemployed with 16.5 percent of African-Americans and 12.6 percent of Hispanics unemployed. The long term unemployed (or those unemployed for 27 weeks or at least 6 months) reached 6.3 million or about 43 percent of all unemployed persons.[20] Moreover, when adding the numbers of involuntary part time workers and discouraged workers to the number of unemployed persons, the portion of unemployed and under-employed Americans is about 16 percent of the workforce.[21]

[19] The current unemployment rate is the highest since 1982 according to historical records of the Bureau of Labor Statistics.
[20] Bureau of Labor Statistics (BLS), Economic News Release, Employment Situation Summary, February 5, 2010, see http://www.bls.gov/news.release/empsit.nr0.htm
[21] Authors calculations from BLS data.

Consistent with other research, NCRC's HAMP survey finds that unemployment has taken over problematic lending as the leading contributing factor for foreclosure. About three quarters of survey respondents cited unemployment or reduction in work hours as the reason for struggling with mortgage payments while 33.5 percent reported problematic loans as the reason for struggling with payments (see accompanying NCRC HAMP report for more information).

The combined impacts of problematic lending and unemployment suggests that a foreclosure prevention program will need to operate on a large scale and offer relatively deep subsidies and reductions in loan amounts in order to provide sustainable loans for distressed homeowners.

IV. Public Sector and Private Sector Modification Efforts Not Keeping Pace

The magnitude of the foreclosure and unemployment crisis calls for aggressive loan modification programs. Despite the best of intentions, the current private and public sector programs do not achieve the scale needed to ameliorate the current crisis.

The approach of the Bush Administration was to encourage the private sector to embark upon a loan modification program. At the urging of the Administration, financial institutions created the HOPE Now Alliance, whose purpose was to coordinate the foreclosure prevention efforts of counseling organizations, servicers, and other financial institutions. The HOPE Now Alliance recorded 3.1 million loan workouts during 2007 and 2008, but two thirds of these workouts deferred or re-scheduled borrower payments without lowering monthly payments.[22] Meanwhile, the foreclosure crisis worsened.

---

[22] Patricia McCoy, *Of Loan Modifications and Write-Downs*, a paper presented at Moving Forward: The Future of Consumer Credit and Mortgage Finance - A National Symposium held by the Joint Center for Housing Studies, Harvard University, February 18, 2010 , p. 5, see http://www.jchs.harvard.edu/moving_forward_symposium/conference_drafts/2-3_mccoy.pdf

The Obama Administration created two programs, the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP) that aimed to increase the number of loan modifications and refinances by offering public subsidies to financial institutions and borrowers. Using $75 billion of funding from the Troubled Asset Relief Program (TARP), HAMP's goal is to reach 3 million to 4 million borrowers. HAMP offers servicers $1,000 for each eligible modification and up to $1,000 each year for up to three years during which a borrower has remained current on loan payments. Borrowers receive $1,000 each year for up to five years as long as they remain current on loan payments. HAMP offers additional subsidies to financial institutions for assisting borrowers current on their payments but at the risk of default, for modifying second liens, and for protecting against house price declines. Through interest rate reductions, loan term extensions, and as a last resort principal forbearance or deferment, a borrower's mortgage payment is to be reduced to no more than 31 percent of his or her monthly income.[23] HAMP offers borrowers a trial modification for three months after which the borrower is eligible for a permanent modification if the borrower is current on the payments during the trial period.

HARP focuses on mortgages held by the Government-Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac. Under HARP, mortgages held by the GSEs can be refinanced into the current low rates as long as borrowers are current on their loans and do not have loan-to-value ratios (LTVs) exceeding 125 percent. Before HARP, the GSEs generally could not finance mortgages with LTVs exceeding 80 percent. Unlike HAMP recipients that are usually delinquent on their mortgages, HARP recipients are current on their mortgages. HARP is intended to make loans more affordable for borrowers and also assist "underwater" borrowers at risk of foreclosure whose outstanding loan amounts exceed the value of their homes. HARP was intended to reach 4 to 5 million borrowers.[24]

[23] The "waterfall" process in the HAMP program takes the servicer or lender through a series of steps for making the loan more affordable. Principal reduction is one of the last steps listed.
[24] Treasury Department information on HAMP and HARP, see Home Affordable Modification Program: Overview, Homeowner Affordability and Stability Plan Fact Sheet, Making Home Affordable.gov – Borrower: Frequently Asked Questions

While a considerable improvement over the previous administration's programs, the Obama Administration's programs are not keeping pace with foreclosures. Almost one year after its inception, the HAMP program has offered about 1.3 million trial modifications but has converted only 170,000 of these trial modifications into permanent modifications.[25] In addition, the HARP program has assisted 190,000 borrowers refinance into lower cost loans.[26] Only 1 percent or about 1,900 of the HARP refinances have involved loans with LTV ratios between 105 percent and 125 percent.[27] It is disappointing that the HARP program has not refinanced more high LTV loans because these loans are at elevated risk of default since the borrowers owe more than the houses are worth. In total, the federal government programs alone are not sufficient to reduce the volume of foreclosures that are running at 2 to 3 million per year.

Even combining federal and private sector efforts, however, still does not overcome the number of foreclosures. According to the OCC and OTS, for every six homeowners in foreclosure at the end of the third quarter of 2009, only 1 is in a loan modification or trial plan.[28] Possibly because of the slow pace of converting HAMP trial modifications to permanent modifications, the ratio of loan modifications in process to loan modifications completed fell from 46 percent in July 2008 to 8 percent by October 2009 according to the State Foreclosure Prevention Working Group.[29] On the positive side, the OCC and OTS find that servicers have implemented almost twice as many home retention actions (loan modifications, short sales, and other alternatives to foreclosures) as new foreclosures in the third quarter of 2009, which is an improvement over previous quarters.[30] While an improvement, it is still not fast enough.

---

[25] Making Home Affordable Program, Servicer Performance Report though February 2010, Treasury Department release of March 12, 2010, p.4, see http://www.makinghomeaffordable.gov/docs/Feb%20Report%20031210.pdf

[26] Dina ElBoghdady and Renae Merle, Refinancing unavailable for many borrowers, Washington Post Staff, Sunday, February 14, 2010; A01.

[27] Federal Housing Finance Agency News Release of January 29, 2010, *Refinance Volumes and HAMP Modifications Increase in December*, see http://www.fhfa.gov/webfiles/15389/Foreclosure_Prev_release_1_29_10.pdf

[28] OCC and OTS Mortgage Metrics Report, December 2009 report on the Third Quarter 2009, p. 6.

[29] State Foreclosure Prevention Working Group, *Analysis of Mortgage Servicing Performance*, Data Report No. 4, January 2010, p. 16, see http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport4Jan202010FINAL.pdf

[30] OCC and OTS Mortgage Metrics Report, December 2009 report on Third Quarter 2009, p. 8.

V. Quality of Loan Modifications

Speed is a necessary but not sufficient element for successful modifications. The modifications must also offer enough of a reduction in monthly payments in order to result in loans that are sustainable and affordable for borrowers. Although the high volumes of reckless lending has created the need for significant reductions in payments, approximately 70 percent of the modifications have actually increased monthly payments according to the State Foreclosure Prevention Working Group.[31] Modifications that increase monthly payments usually involve tacking on missed payments and late fees onto outstanding principal. In contrast, only 9 percent of loan modifications reduce loan principal by more than 10 percent. Since the great majority of loan modifications increase monthly loan costs, it is not surprising that the re-default rate on modifications is high. The OCC and OTS find that about half of all loan modifications re-default after six months.[32]

Fortunately, the most recent modifications usually involve reductions in monthly payments, but the evidence is mixed regarding how deep the reductions are. The OCC and OTS report that 80 percent of all loan modifications in the third quarter of 2009 reduced monthly payments. Modifications with principal reductions were 13 percent of all modifications in the third quarter, up from 3 percent in the first quarter of 2009.[33] The NCRC HAMP survey is consistent with low percentages of principal reductions. In fact, only one of the 179 respondents in the NCRC survey received a principal reduction; two respondents received a principal forbearance.

According to the recent Treasury Department report, 27 percent of HAMP permanent modifications involved principal forbearance.[34] However, it is unclear how much of a reduction in principal is occurring in the HAMP modifications. The median debt-to-

[31] State Foreclosure Prevention Working Group, January 2010, p. 2.
[32] OCC and OTS Mortgage Metrics Report, December 2009, p. 5.
[33] OCC and OTS Mortgage Metrics Report, December 2009, p. 5.
[34] Making Home Affordable Program, Servicer Performance Report though February 2010, Treasury Department release, p.6.

income ratio of a permanent modification is still a high 59 percent.[35] In other words, after a HAMP permanent modification, payments on all debt still consumes almost 60 percent of a borrower's income.

Re-default rates are much lower for modifications that involve significant reductions in monthly loan payments. The OCC and OTS find that 38.6 percent of modifications that reduced payments by 20 percent or more re-defaulted while 66 percent of modifications that did not reduce payments re-defaulted after one year.[36] Though mixed, the evidence suggests that the trends are in the right direction in terms of the extent of reductions in monthly payments. The question remains whether these trends will continue and whether the speed of modifications will increase sufficiently.

VI. The Need for Principal Reduction

As discussed above, significant reductions in monthly payments are needed for successful and sustainable modifications. Oftentimes, the most effective means to offer significant reductions in monthly loan payments is to offer reductions in loan principal or the outstanding loan amount. About 25 to 30 percent of homeowners in this country have negative equity, meaning that they owe more on their outstanding loan balance than their homes are worth. A number of these borrowers will lose their incentive to continue making loan payments because equity losses are substantial. Even after several years of making payments, these borrowers may not have accumulated any equity, particularly in parts of the country experiencing sharp home price declines. Much has been written about strategic defaults, or borrowers simply walking away from what looks like a hopeless proposition of reclaiming their wealth. In addition, other "underwater" borrowers end up defaulting because they are struggling with monthly payments and find themselves unable to qualify for refinance loans due to negative equity.

---

[35] Treasury Department, p.6.
[36] OCC and OTS Mortgage Metrics Report, December 2009, p.7.

In paper last summer, the Center for Community Capital found that loans involving principal reduction are least likely to re-default, using a sample of nonprime loans and controlling for loan characteristics, borrower characteristics, local economic conditions, and servicer practices. Because a loan modification with a principal reduction reduces LTV, the modification has lower re-default probabilities even when it results in same monthly mortgage payment as an interest rate reduction. The paper revealed that a combination of principal and rate reduction lowers re-default probability by 19 percent while rate reduction only lowers re-default probability by 13 percent. In addition, deeper reductions in monthly payments were more effective; reducing a borrower's payment by 5 to 10 percent lowers the probability of re-default by 10.3 percent, but reducing payment by 30 to 40 percent lowers the probability of re-default by 18 percent. Finally, borrowers with negative equity are more likely to default than borrowers with equity.[37] The paper maintains that "principal forgiveness modification has the lowest re-default rate very likely because it addressed both the short-term issue of mortgage payment affordability and the longer-term problem of negative equity."[38]

In a follow-up paper, the Center for Community Capital offers valuable and practical suggestions for geographical targeting of various types of modifications. The Center suggests that when the desired payment reduction needs to be large, Net Present Value (NPV) tests indicate that a combination of rate and principal reduction is most effective. Principal reduction is the best option according to the NPV tests when payment reductions of 20 to 30 percent are needed. In addition, principal reductions are most effective in states with high levels of subprime lending, steepest price declines, highest foreclosure rates, and weak job markets. In particular, principal reductions are especially needed in California, Nevada, Arizona, and Florida. In contrast, in other geographical

[37] Roberto G. Quercia and Lei Ding, *Loan Modifications and Redefault Risk: An Examination of Short-term Impacts*, Working Paper, July 21, 2009, Center for Community Capital, pp. 13-14, see http://www.ccc.unc.edu/documents/LoanMod_Redefault_7.20%202009.pdf
[38] Ibid., p. 16.

areas where borrowers have some equity, rate reductions and loan term extensions are feasible.[39]

A Government Accountability Report (GAO) issued this past December sheds additional light on geographical areas most in need of principal reductions. In 16 large metropolitan areas, an incredible 59 percent of nonprime borrowers had negative equity. This included 94 percent of nonprime borrowers in Las Vegas, 89 percent in Phoenix, 86 percent in Miami, and 80 percent in Minneapolis. The total amount of negative equity for nonprime borrowers (the difference between outstanding loan balances and property values) was $54 billion overall and $36,000 for the median borrower.[40] The negative equity estimate looms even larger in terms of wealth loss for nonprime borrowers and their neighborhoods if many of these borrowers subsequently default absent foreclosure prevention assistance. In addition, negative equity loses for all borrowers are much larger. The 25 percent drop home prices from the 2006 peak has left homeowners underwater by $745 billion, according to First American CoreLogic.[41]

VII. Barriers to Modification

Losses to lenders on nonprime foreclosures are as high as 50 percent, yet the pace of modifications remains frustratingly slow.[42] It would seem that it would be preferable for a financial institution to modify a loan and take a loss of 20 to 30 percent or even 40 percent rather than undergo the considerable costs associated with a foreclosure. However, several structural, institutional, and financial barriers to modifications include compensation mechanisms, credit rating agencies, and second liens, which are now reviewed in turn.

---

[39] Roberto G. Quercia and Lei Ding, *Tailoring Loan Modifications: When is Principal Reduction Desirable*, Working Paper - August 23, 2009, Center for Community Capital, pp. 16-20, see http://www.ccc.unc.edu/documents/Tailor.Loan.Mods.8.23.09.pdf

[40] Government Accountability Office, *Loan Performance and Negative Home Equity,* p. 14 & 17.

[41] John Gittelsohn and Prashant Gopal, *Principal Cuts on More Lender Menus as U.S. Foreclosures Rise,* Bloomberg, January 7, 2010.

[42] Chairman Ben. S. Bernanke, *Housing, Mortgage Markets, and Foreclosures*, Speech, December 4, 2008 at the Federal Reserve System Conference on Housing and Mortgage Markets, Washington DC, see http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm

Case Study of NCRC Housing Network Client

Patricia Stringer is a resident of the District of Columbia; she is a single parent who has worked her entire life to make sure her son is well taken care of. In 1988, she purchased her family home from her mother.

After her mother was diagnosed with dementia, she became her primary caretaker. This caused more stress and a greater burden to cover the bills. When she contacted her lender, they told her that they could refinance her loan to help cover the increased balances on her credit cards and to pay off her son's education loans. They also suggested that she go to another lender to get a second mortgage as her home had plenty of equity in it and could help pay the bills; she followed their advice and got a second mortgage.

When gas reached $4 a gallon, she became stretched again because she depends on her car to get to her job. Her savings account became depleted and she turned to taking out loans on her 401K until she was told she was no longer allowed to do so. After many months, she was no longer able to stay current on her mortgage, and she even had to turn to neighbors to buy food. She missed a few payments and then contacted NCRC. NCRC arranged a workout with both lenders, holding the first and second mortgage, but then the lender with the first mortgage balked.

Facing foreclosure, she moved out of her house and rented an apartment in February 2009. NCRC was then able to get her a three month HAMP trial loan and the lender cancelled the foreclosure sale. She moved out of the apartment and back into her house in April. The landlord told her that she would have to pay 6 months of rent because she had broken her lease without 30 days of notice. NCRC stepped in and is negotiating with the landlord.

She made two payments on her trial HAMP loan but then was sent another agreement in June 2009 with a different payment amount. She made her payments for five months, only to be told that her permanent modification had been denied because of missing information. This was not the case as all documents had been submitted. Her counselor at NCRC tried several times to get the lender to reduce the amount she owed but was not successful even though the house's value is now less than the amount she owes.

Seeing that the lender was intent in denying her again, NCRC asked them to review the file one more time. She was not sleeping well and crying almost every night because the lender told her she was in foreclosure again.

Until recently, Ms. Stringfield was in her fourth HAMP trial modification. The Net Present Value (NPV) test rejected her application for a permanent modification in December of 2009. The fourth HAMP trial modification was signed last month by Ms. Stringfield. Ms. Stringfield also testified before the Domestic Policy Subcommittee of the Government Oversight Committee of the House of Representatives last month. After her testimony, she finally received a permanent modification. It should not take testimony before Congress to receive a permanent modification.

Compensation Mechanisms: In a recent article for a Harvard symposium, Law Professor Patricia McCoy postulates that compensation mechanisms for servicers provide a

disincentive for principal write-downs and substantial reductions in monthly borrower payment. Servicers typically collect a fee of 25 to 50 basis points of the outstanding loan amount.[43] Thus, servicers have a disincentive to reduce the principal amount because that type of modification directly reduces their fee. Instead, servicers may prefer interest rate reductions or adding arrears and fees to the outstanding loan amount because these types of modifications do not directly affect the principal and thereby cut into their fees. Interestingly and coinciding with McCoy's theory, the OCC and OTS find that the great majority of principal reductions occur in loans held in lender portfolios rather than loans serviced for investors.[44]

The costs associated with foreclosure prevention and modification are not recouped by the servicer since the servicing fee remains flat and is not adjusted to compensate for foreclosure prevention costs. The flat fee therefore makes foreclosure less costly than modification for the servicer. HAMP addresses this to some extent by providing subsidies for modification. Yet, it is also possible that the servicers may have an incentive to provide temporary rather than permanent modifications since temporary modifications involve less underwriting and fewer costs.[45]

Credit Rating Agencies: Credit rating agencies make their ratings of servicers conditional on servicers not delaying foreclosures on distressed loans.[46] Coupled with compensation mechanisms that discourage modifications, credit rating agency assessment of servicer performance is a strong incentive for servicers to pursue foreclosure. In fact, a common complaint by counseling agencies is that foreclosure proceedings do not stop while they are trying to help a borrower modify a loan.

The credit rating agencies also exacerbated the foreclosure crisis in communities of colors by awarding inflated ratings to reckless nonprime lending. NCRC has filed

---

[43] Patricia McCoy, *Of Loan Modifications and Write-Downs*, a paper presented at Moving Forward: The Future of Consumer Credit and Mortgage Finance - A National Symposium held by the Joint Center for Housing Studies, Harvard University, February 18, 2010 , p. 11, see http://www.jchs.harvard.edu/moving_forward_symposium/conference_drafts/2-3_mccoy.pdf.
[44] OCC and OTS Mortgage Metrics Reports for Third Quarter 2009, released December 2009, p. 25.
[45] McCoy, p. 13.
[46] McCoy, p. 13.

discrimination complaints with the Department of Housing and Urban Development alleging that the credit rating agencies (Standard & Poor's, Fitch, and Moody's) violated the Fair Housing Act by fueling imprudent mortgage lending.[47]

Second Liens: The interests of financial institutions holding the first and second mortgages of distressed borrowers often diverge and thus prevent modifications. In some cases, the second lien holder will not allow the first lien holder to modify the loan because the second lien holder believes that its claim for borrower payments may be wiped out by the modification. In other cases, McCoy states that under existing law if a first mortgage undergoes significant modification, the holder of the first mortgage loses its status as a first mortgage holder and the second mortgage holder is now in the first position for receiving loan payments.[48] No satisfactory mechanism has yet been established to deal effectively with the issue of second liens. The HAMP program has a second lien component offering subsidies for second lien holders to participate in modifications. Bank of America and Wells Fargo are to be commended as the only banks that have signed up to participate in the HAMP second lien program. It is quite disappointing that no other bank has done so.[49] Moreover, there is a paucity of data that would reveal how many second liens have been modified by the HAMP program. The resistance to modifications posed by second liens is a tremendous barrier since about one third of subprime 2/28 hybrid ARMs issued in 2005 and 2006 also had second lien loans.[50]

NCRC's HAMP survey confirms the obstacles posed by second liens. Thirty five percent of survey respondents with one mortgage received a modification, but only 16.3 percent of respondents with two mortgages received a modification.

---

[47]See January 2009 NCRC press release via http://www.ncrc.org/index.php?option=com_content&task=view&id=409&Itemid=75
[48] McCoy, p.15.
[49] Renae Merle, *Administration Pushed to Expand Foreclosure Program: Jobless Homeowners Need More Help, Housing Advocates Say*, Washington Post, February 18, p. A13.
[50] McCoy, p. 15.

Foreclosure Scams: Recalcitrant lenders and servicers are not the only obstacles to modifications. Abusive foreclosure service providers that are bent on stealing consumers' money and homes are a significant barrier to responsible modifications. For example, one of the respondents in NCRC's HAMP survey paid a foreclosure scam artist $4,000 to seek a modification.

VIII. Experience of NCRC Housing Counselors

NCRC's Housing Counseling Network is a HUD Certified National Housing Counseling Intermediary and a participant in the NeighborWorks National Foreclosure Mitigation Program. NCRC and our member organizations assist borrowers in negotiating with servicers and other financial institutions, and this year will train over 1,000 housing counselors to identify and overcome fair lending and fraud issues while working on behalf of consumers. Each year, NCRC and our members work with more than 10,000 consumers. In a previous report, NCRC estimated that the 5,000 modifications and refinances spearheaded by the Housing Counseling Network saved borrowers about $500 million in equity.

Institutional Capacity Constraints: NCRC's housing counselors report that the HAMP program has been "unpleasant and frustrating." NCRC's HAMP survey revealed that 43 percent of respondents described their experience with servicers as "bad" or "very bad," a quarter said their experience was "fair" while the minority (31 percent) described the experience as "good." Some observers suggest that servicers have been established as collection agents, collecting and processing borrower payments. The servicers are therefore not equipped to deal with a foreclosure crisis. NCRC's counselors' experience comports with this observation.

NCRC's counselors report that the initial phone call is with a servicer's customer service representative. This call is often cordial, and initial intake items such as documentation are discussed. However, in a number of cases, the customer service representative subsequently has erroneous information regarding the loan. To compound the frustration,

in the great majority of cases, the counselors cannot speak to the next layer of personnel in the servicing company.

The next layer of personnel in servicing companies is known as negotiators. The negotiator has underwriting discretion, but NCRC's counselors do not have access to the negotiator. The customer service representative is the go-between between NCRC counselors and the negotiator. The customer representatives, however, are usually not equipped with the knowledge to effectively communicate about the complexities of loan modifications. As a result of this cumbersome process, communication is difficult.

Meanwhile, the negotiator is actually negotiating with the homeowner over terms of the modification and will send modification offers to the homeowner. Without direct communication with the negotiator, the NCRC counselors believe they cannot safeguard the interests of the homeowner. For example, the negotiator will often send modification offers that look like HAMP modifications and even have similar language or logos, but in fact, the modifications are the bank's own internal modification offers, which are usually not as beneficial for the borrower. NCRC counselors question the ethics of this practice.

In addition, losing documents is commonplace. NCRC's counselors often have to re-submit documents four or five times. In NCRC's HAMP survey, 70.6 percent of respondents had to re-submit documents and those that had to re-submit documents did so an average of three times. NCRC's counselors assert that there should be a standard technological tool such as e-faxes for submitting documents that ensure that documents are stored and not lost.

According to the NCRC counselors, the current process is not well equipped to produce an "end result." Moreover institutional reforms such as the HAMP escalation process and the special counselor hotline have not been effective.

In perhaps an acknowledgment of limited capacity, a recent trend involves financial institutions selling distressed loans to other institutions as the modification process has

started. NCRC's counselors surmise that the selling institution does not want to deal with the complexities of the modification. In some cases, the loan sales are to financial institutions which are seeking a niche as modification specialists. These quick sales, however, complicate the counselors' efforts since they must essentially start over with a new institution.

Quality of Modifications: The extent of underwriting before the borrower receives a trial modification affects the ability of the borrower to achieve a durable solution by transitioning into a permanent modification. According to NCRC's counselors, some large financial institutions qualify borrowers for trial modifications based on the borrowers' verbal representations of income and other underwriting variables while other institutions qualify borrowers for trial modifications based on documents. The quicker qualification process gets a borrower into a trial modification faster but tends to delay the transition to the permanent modification. In these cases, documents need to be retrieved at the end of the trial modification time period. Then, additional underwriting and changes to the modifications often need to occur to take into account inconsistencies in information gathered during the trial and permanent modification process. Trial modifications can stretch into a time period of six months or more as these inconsistencies are ironed out. Stress for all parties increases during this uncertain time period.

Recently, the Administration released new HAMP guidelines requiring a standard set of documents to be obtained as borrowers are being evaluated for trial modifications.[51] This will hopefully reduce inconsistencies among institutions for evaluating borrowers for trial modifications, bolster the quality of underwriting during the trial modifications, and will make the transition between trial and permanent modifications more efficient.

In addition to the quality of modifications, timeliness is also a pressing issue. The HAMP program offers subsidies to financial institutions to assist borrowers at risk of

[51] *Administration Updates Documentation Collection Process and Releases Guidance to Expedite Permanent Modifications*, January 28, 2010 press release, http://www.makinghomeaffordable.gov/pr_01282010.html

imminent default. However it is a general practice for servicers not to review "imminent default" files in a timely manner to possibly cure the default. These files are often handled differently and are placed in the back of the queue according to NCRC's counselors. Sound principles taught by HUD certified counselors to contact the lender early if the borrower foresees payment difficulties is all for naught.

Regarding permanent modifications, NCRC's counselors report that the modifications usually offer interest rate reductions and that the modifications do not achieve the optimal solution in terms of affordability for borrowers. The interest rate modifications often offer rates of 4 to 5 percent and rarely reach the lowest rate of 2 percent permissible under the program. While the higher rates might be affordable for a number of borrowers, there are cases in which the lowest rate is needed. In addition, principal reduction is rare in the experience of NCRC's counselors. Instead of offering principal reduction, servicers are tacking stiff and expensive "balloon payments" to the end of loans. On occasion, interest rate reductions have been accompanied by fees added to the loan amount or upfront fees, which can actually increase monthly payments for borrowers experiencing financial distress.

Case Study of NCRC Housing Network Client

Mrs. Carmichael reached out to her mortgage company in August of 2009 for assistance with her mortgage payment. She has worked as a commissioned employee for a number of years but due to the slow economy her income has dropped significantly. In addition to her financial worries Mrs. Carmichael has began treatment for breast cancer. Her insurance does not cover a huge portion of her treatment which has added to her financial burdens.

In late September Mrs. Carmichael received the news she had been seeking. Mrs. Carmichael was approved for the trail payment plan under Making Home Affordable. The new payments were for $1,289 per month which was a significant drop from her normal payment of $2,148. Mrs. Carmichael made all her payments in the trial modification and looked forward to getting a permanent modification.

On March 2, 2010 she received notice that her request for permanent loan modification under Making Home Affordable Modification Program was denied. It was determined that default was not imminent on her loan. This determination was made because her financials showed that she had more than 3 months of payments in savings. This same information was provided on her initial application prior to being approved for the trail period. More importantly her current payments still exceed 31 percent of her current income making her existing mortgage unsustainable. Even though she tried speaking with a servicer representative about her dilemma, she was only given an option of making the payment or selling her home.

NCRC counselors observe that the haphazard quality of loan modifications reflects financial institution ambivalence about the HAMP program. Some institutions may be going through the motions and not seeking permanent modifications in which they have to make significant financial sacrifices because they may be waiting for additional government subsidies or even outright purchases of their distressed loans. The continued reluctance to offer principal reductions most likely reflects an aversion to taking a "haircut" (accepting a loss, which would probably be less than the loss associated with foreclosure but still a significant loss). Finally, other institutions may still prefer their own internal modifications and steer borrowers towards them since private sector programs typically modify loans for five years (and then require a refinance) whereas a HAMP modification locks in loan terms and conditions for 30 years. Professor McCoy also suggests a possibility of gaming the system by some servicers. She states, "At worst some servicers may be playing a cynical game of pocketing HAMP payments at the temporary modification stage with no intent of graduating to permanent modifications."[52]

[52] McCoy, p. 21.

Denials of Loan Modifications: The HAMP program features a Net Present Value (NPV) analysis that requires financial institutions to assess if the value of the modification exceeds the value of a foreclosure for investors owning the distressed loans. Since losses associated with foreclosure are steep, it was anticipated that the NPV analysis would promote modifications. The NPV analysis, however, is opaque to NCRC's counselors and many other counseling organizations since the formulas used by the NPV model and the inputs (variables considered by the model) have not been revealed by the Administration. Denials of loan modifications appear to be arbitrary and hamper appeals of denials. Counselors do not know the underwriting variables used by the model and whether the data for the variables was even accurate. It is not possible for counselors to assess whether borrower income data, property value, or other data used by the model was accurate.

Case Study of NCRC Housing Network Client

Norma Ruiz has been denied a HAMP modification four times already and each time it is due to a failure of the NPV test and by a miscalculation of income. NCRC's counselor is submitting the borrower's documents for the fifth time. Meanwhile the servicer has attempted three sales of the home. NCRC's counselors report that Norma's situation typifies the use of the NPV as a blanket denial system without explaining the numbers used to make the determination of eligibility.

Servicers are also denying HAMP modifications for homeowners if they have any savings or a retirement account, such as 401K or 403B. In anticipation of reaching a sustainable loan modification, NCRC's counselors generally advise their customers to establish savings. But when servicers request new financial information and see the savings they deny the loan. So, in essence homeowners are being penalized for being responsible and saving money to save their home.

IX. Recommendations

As discussed above, the pace of loan modifications needs to be significantly increased and the quality of modifications needs to be bolstered. Deeper reductions in principal loan payments need to occur, particularly in parts of the country experiencing high levels of negative equity. The recommendations below address the limitations of the HAMP and HARP program as well as including recommendations for preventing future foreclosure crises.

NCRC's HELP Now Proposal

In early 2008, NCRC proposed the establishment of a national Homeowners Emergency Loan Program (HELP Now). It would authorize the Treasury Department to buy troubled loans at steep discounts (equal roughly to their current write-downs by financial institutions) from securitized pools. This would result in a relatively low cost to taxpayers. The government would arrange for these loans to be modified through existing entities such as Fannie Mae and Freddie Mac, and then sell the modified loans back to the private market. The program would be relatively easy to implement, as it does not require the creation of a new entity.

The purchase discounts would be applied to the modification of problem loans to create long-term borrower affordability. Reflecting the write-downs by financial institutions, the government would purchase loans at a 30 percent to 50 percent discount. The write-downs would address the need for deep reductions in principal, particularly in parts of the country experiencing steep price declines and high levels of negative equity. If the discounted loans are still not affordable for some borrowers, the government could offer a low-interest second mortgage that could be due upon sale of the property.

The HELP Now proposal would rely on the federal government's power of eminent domain in order to purchase loans from investors and servicers. The current economic crisis would justify the government's use of eminent domain laws for a compelling public

purpose. The statutory language establishing the Troubled Asset Relief program (TARP) also provides the authority for the approach of the HELP Now proposal.[53]

Eminent domain would overcome several barriers. Through compulsory purchases of troubled loans, HELP Now does not have to overcome the series of financial and institutional impediments to coax reluctant servicers, investors, and lenders to participate—unlike the voluntary programs. Utilizing the federal government's power of eminent domain avoids lawsuits from disgruntled investors. Furthermore, as Harvard Law Professor Howell Jackson points out, eminent domain can also solve the barriers related to first and second liens by directly purchasing all mortgages on targeted properties.[54]

The use of eminent domain can alleviate pricing uncertainties and therefore unfreeze the credit market. The eminent domain method can establish fair prices for mortgages through existing judicial mechanisms.[55] Once fair prices are established, a secondary market can then be reestablished and voluntary efforts to refinance mortgages will probably accelerate. In order to unglue markets quickly and to target the greatest need, Professor Jackson proposes that eminent domain focus on the most problematic loans in geographical areas of the country where home prices have fallen significantly. This is similar to the targeting recommendations of the Center for Community Capital.

After the government has used eminent domain for a significant amount of loan purchases, HELP Now could also use reverse-auction mechanisms. In a reverse auction, financial institutions will name their price for selling troubled loans to the government. The objective will be to move HELP Now to more of a voluntary model and to accelerate

---

[53] Title I, Section 101 of H.R. 1424, the Emergency Economic Stabilization Act of 2008, states that "The Secretary is authorized to establish the Troubled Asset Relief Program (or `TARP') to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures developed and published by the Secretary." Troubled assets are defined as residential mortgages and any securities related to such mortgages.

[54] Professor Howell E. Jackson memo to the House Financial Services Committee, November 28, 2009, on file at NCRC.

[55] In cases of price disputes when the government has used eminent domain, a judge or mediator will rule on a fair price.

loan modifications after the most troubled loans have been removed from the financial system via the use of eminent domain.

HELP Now would be an efficient use of government resources. As NCRC originally proposed, HELP Now would require an initial government outlay of about $50 to $100 billion to purchase loans and would institute a revolving loan fund mechanism. Now that $75 billion has been allocated to HAMP, a HELP Now approach can use a portion of that funding, the level of which would be determined by a needs analysis focusing on the areas of the country with the steepest price declines, and highest levels of negative equity and subprime lending.

The government would be reimbursed for its loan purchases after it sells the loans (which have been modified) to Fannie Mae, Freddie Mac, or private sector investors. Moreover, the government would be able to establish mandatory underwriting criteria in order to guard against re-defaults. Unlike the Hope for Homeowners and the FDIC's Indymac program, the government would not guarantee the loans would therefore not assume significant losses.

The large-scale modification program must also use neutral third-party counselors to represent the interests of borrowers. A key to NCRC's Housing Counseling Network's success is the intervention of counselors from a non-profit organization that represents the borrower, and not the interests of the lender, servicer, or government. The counselors are therefore able to ensure that borrowers obtain an affordable and sustainable mortgage. Under a TARP program, the counselors should be empowered to review the proposed modification and suggest any further alterations necessary to achieve long-term affordability.

The government could also ensure that renters receive protections under its program. A sizable number of distressed loans involve investors who do not live in the property and have rented the properties to tenants.[56] Currently, tenants face eviction with little or no

[56] Fifteen million tenants or about 40 percent of all renters live in single family homes, many of which are owned by small scale investors. A segment of this large population is at risk during the current foreclosure crisis. See J.W. Elphinstone, What if Your Landlord Faces Foreclosure, Associated Press article appearing in the Washington Post, January 3, 2009.

notice after a foreclosure. In these cases, the government must provide sufficient time and relocation assistance for the tenants.

Establish Loan Program for Unemployed

The rapidly increasing unemployment rate is now driving foreclosures. In order to keep pace with rising unemployment, Congress and the Administration should consider implementing a program like Pennsylvania's Home Emergency Mortgage Assistance Program (HEMAP). When a homeowner becomes unemployed involuntarily, the state's housing finance agency will arrange for a two-year loan of up to $60,000 to enable the homeowner to continue making payments until the borrower's income recovers.[57] Since the program's inception in 1983, HEMAP has assisted more than 40,000 homeowners. The program is cost-effective in that it received an initial state appropriation with subsequent funding that came from borrower loan repayments. A federal program like HEMAP would most likely require a significant initial capital outlay, but could be sustainable through self-financing.

H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009 which passed the House, would make available $3 billion of Troubled Asset Relief Program (TARP) funding for loans to families and households experiencing unemployment. Modeled after the HEMAP program, each household would receive up to $50,000 for assistance in paying their mortgage. In addition, $1 billion in TARP funding would be made available to state and local governments for the redevelopment of abandoned and foreclosed homes.

In an announcement last month, the Administration also unveiled a $1.5 billion initiative to be funded from TARP that would provide financing to state housing agencies in five states experiencing the greatest home price declines to design programs to assist the unemployed stay in their homes, to provide relief to households experiencing negative

---

[57] See http://www.phfa.org/consumers/homeowners/hemap.aspx and http://www.phfa.org/forms/brochures/foreclosure_prevention/HEMAP_2008.pdf.

equity, or to resolve loan modifications involving second liens.[58] This is a welcome announcement that allows housing agencies to respond flexibly to pressing local needs. In order to adequately address needs in states beyond the five targeted in this initiative, the funding level will need to be supplemented with the funding for the unemployed homeowners in H.R. 4173 and other resources.

Process Improvements in HAMP

As discussed above, several procedural and capacity issues hamstring HAMP's effectiveness. If servicers continue to exhibit widespread incompetence in receiving forms and storing information, the Administration ought to consider placing the responsibility of HAMP modifications with independent third party agents such as nonprofit organizations. In addition, blatantly unfair aspects of the process must end. Foreclosure proceedings must be halted while modifications are in process. We are encouraged about media reports indicating that the Treasury Department intends to halt foreclosure proceedings while borrowers are in a trial modification.[59] It is unclear, however, how many other protections are being contemplated by the Treasury Department. For example, will this new policy apply to borrowers being evaluated for trial modifications? What will HAMP's rules be regarding foreclosure proceedings while a borrower is appealing a HAMP denial? NCRC hopes that the Treasury Department errs on the side of protecting consumers and prohibits all aspects of the foreclosure proceedings until all non-foreclosure alternatives are exhausted.

The NPV analysis must be transparent (both the NPV formula and the data used) so that counselors and borrowers can appeal denial requests. The Administration should also establish rules for a fair appeal process.

[58] The five states are California, Nevada, Arizona, Michigan, and Florida. For more details on the program, see White House, Office of Press Secretary, *President Obama Announces Help for Hardest Hit Housing Markets*, February 19, 2010, http://www.whitehouse.gov/the-press-office/president-obama-announces-help-hardest-hit-housing-markets.

[59] "Obama Mulls Changes to Mortgage Program: More consumer protections may be added to fix long-standing complaints," Associated Press report 3:30 PM, February 22, 2010, accessed via http://www.msnbc.msn.com/id/35525942/ns/business-real_estate/.

Fair Lending Investigation in the HAMP Program and Participating Servicers

NCRC's survey findings of racial disparities in receiving modifications call for a thorough fair lending investigation of the HAMP program and participating servicers. The investigation should assess if the HAMP program guidelines and NPV test contain any elements that have a disparate impact on protected classes that is not justified by business necessity. In addition, do the servicers engage in any practices that result in disparities or, worse, are discriminatory in intent and effect?

Second Liens and Short Sales

Banks own a significant amount of second liens. The regulatory agencies must recognize the reluctance to modify second liens as both a consumer protection/fair lending and a safety and soundness issue. If a high percentage of second liens default, the safety and soundness of the banks are undermined.

Related to the stubbornness of holders of second liens to modify their loans is the short sale program recently announced by the Treasury Department. The short sale program must not become a convenient excuse for not modifying difficult loans, including those with second liens. The short sale program must truly become a last resort for borrowers who cannot afford loans even after modification. Congress and the Treasury Department must monitor the use of short sales carefully to ensure that lenders and servicers do not abuse the short sale program.

Enhance Public Data on Loan Modifications

H.R. 4173 requires the monthly disclosure to the public of data relating to modifications executed as part of HAMP. Lenders and servicers would report the number of applications for modifications they processed, approved, and denied. The data would be publicly reported on an individual record level. Currently, the Treasury reports on HAMP are cursory without detail on the extent of principal reductions, the reductions in

interest rates or changes in other loan terms and conditions. The OCC and OTS mortgage metrics reports are more detailed but do not present the information for HAMP and non-HAMP modifications separately. The data must also be similar to Home Mortgage Disclosure Act (HMDA) data and disclose the information of applications, approvals, and denials by race, gender, age, and income. HMDA-like disclosure would enable stakeholders and policymakers to assess if fair lending disparities are present in the modification process.

HARP Improvements

Considering that Fannie Mae and Freddie Mac, entities in government conservatorship, own or guarantee the mortgages eligible for the HARP program, it is baffling why there has not been more refinances. Perhaps, the Administration should consider placing nonprofit organizations in charge of underwriting or have them as serve as borrower advocates. Nonprofit organizations could be assigned blocks of Fannie and Freddie mortgages that exhibit problematic features such as option ARMs and then represent borrowers who are interested in refinancing into lower rates.

Require Loss Mitigation before Foreclosures and Bankruptcy reform

The power imbalance between financial institutions and borrowers certainly contributes to the slowness and difficulties of securing affordable and sustainable modifications and refinances. A way to reduce the power imbalance and provide incentives for modifications is to establish more checks and balances in the process. For example, before the foreclosure process is started, the financial institution must demonstrate that it has engaged in reasonable loss mitigation efforts including modifications and when modifications are not feasible, short-sales, deeds-in-lieu, and other foreclosure alternatives. Representative Maxine Waters has introduced bills to require reasonable loss mitigation efforts. In addition, the bankruptcy laws must be reformed. Currently, a borrower in bankruptcy can ask a judge to modify almost any type of loan, including consumer loans for luxury items such as yachts. Yet, the current law prohibits borrowers

from asking judges to modify loans for their primary residences. If bankruptcy law was reformed to permit this, financial institutions would have an incentive to correct problematic loans or face the possibility of being ordered to do so by a judge.

Stop Foreclosure Prevention Scams

NCRC's foreclosure prevention service provider report underscores the need for an effective legislative solution and increased public and private sector oversight combined with effective education and outreach to ensure consumers work with responsible providers. Modification companies are often operating in a regulatory vacuum, without any accountability, and today, may be one of the factors blocking consumer access to the Home Affordable Mortgage Program and the Home Affordable Refinance Program. H.R. 1231, the Foreclosure Rescue Fraud Act of 2009 introduced by Representative Gwen Moore, prohibits foreclosure consultants from receiving compensation before services are provided and requires consultants to provide their clients with contracts, subject to a three-day rescission period.

Preventing Future Crises

If we learn nothing else from this crisis, it must be that Congress must take aggressive steps to ensure that a crisis of this magnitude must not be repeated again. The Community Reinvestment Act (CRA) requires banks to serve all communities, including low- and moderate-income communities, consistent with safety and soundness. As NCRC has testified on previous occasions before Congress, applying a law requiring the provision of responsible loans and financial services broadly throughout the financial sector would have averted a crisis of this magnitude. Therefore, NCRC urges Congress to consider CRA modernization bills such as H.R. 1479 as Congress considers financial regulatory reform legislation. Just as the House attached an anti-predatory lending bill to H.R. 4173, so should Congress attach a comprehensive CRA modernization bill to financial regulatory reform legislation. Finally, passing rigorous community reinvestment and consumer protection laws will not be enough if Congress does not

empower a strong independent agency to enforce the laws. Lax regulatory enforcement contributed to the crisis by enabling abusive and deceptive lending practices. Consumer protection was but one of many competing priorities for a multitude of agencies that had trouble coordinating an approach to consumer protection. Therefore, a Consumer Financial Protection Agency (CFPA) must be established as a strong, independent agency whose mission is protecting and promoting safe and sound lending and other financial services for consumers and communities. The CFPA must have jurisdiction over all consumer protection and fair lending laws, including CRA, in order to adequately safeguard the interests of consumers and neighborhoods.

X. Conclusion

The nation is currently experiencing the worst recession since the Great Depression. Dire economic times require bold leadership from the public and private sectors. Self-interest must give way to the national interest. Financial institutions must sacrifice and offer significant concessions for their self-interest (removing toxic loans from their portfolios) and for the overall economic interest. While an improvement over the previous Administration's programs, the HAMP and HARP programs are not delivering modifications and refinances on the scale and quality required to resolve the foreclosure crisis.

It is time to complement the voluntary nature of HAMP and HARP with mandatory programs such as the NCRC HELP Now proposal, which would be targeted to the most distressed parts of the country as measured by the extent of negative equity, foreclosure rates, and nonprime lending. A number of actions can also be taken to bolster the efficiency and equity of the HAMP and HARP programs including a larger role for nonprofit organizations to advocate on behalf of borrowers, more transparency and data regarding loan modification approvals and denials, a halt to foreclosures while modifications are in process, and establishing fair appeal processes for borrowers denied modifications. New programs and approaches to assist unemployed homeowners must be established immediately if we are to prevent negative feedback loops between

foreclosures and unemployment. Finally, future crises must be averted by Congress enacting financial regulatory reform that includes CRA modernization, a comprehensive anti-predatory lending law, and a strong and independent CFPA.