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Best Intentions: The Highs and Lows of the Home Affordable Modification Program

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Roughly 3.9 million foreclosures have occurred in the United States since 2007, and an additional 8-10 million mortgages are still threatened with foreclosure—nearly one out of five mortgages outstanding today. Congress and the Administration have responded to this crisis with a number of programmatic and policy responses. This paper examines the evolution of the government foreclosure mitigation efforts—primarily the **Home Affordable Modification Program (HAMP)**, examines their efficacy, and posits recommendations for further action to assist American homeowners who find themselves in financial distress and at risk of losing their primary asset, their home.

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Homeownership remains a critical component of wealth building and asset accumulation for U.S. families. A home historically has offered families the single most reliable way to build wealth, wealth that can be used for other critical needs, such as higher education, and that can be passed on to future generations. This opportunity has not always been available on equal terms for all Americans, however. Latinos, Hispanic-Americans, and African-Americans in particular have historically had homeownership rates well below those of White Americans—far fewer than 50 percent for these minority communities, and well over 70 percent for white families. Cruelly, the foreclosure crisis has hit these minority families and their neighborhoods the hardest. Getting the national response to the mortgage crisis "right" is therefore not only important to the overall economy, of which housing is a large and important component, but to current homeowners, particularly owners of color, and for the rising generation of new households, whose minority share of the population will be significantly higher than at any other time in the nation's history.

Understanding how responses to the mortgage and foreclosure crisis that erupted in 2007 have worked—or failed to work—is therefore a critical part of designing and enacting a durable set of policies that will enable families once again to gain a foothold in building assets and wealth through stable, safe financing for homeownership, with a higher

degree of confidence that those who do encounter problems will be quickly and appropriately served. Consumers have a clear responsibility to discharge their obligations and do their utmost to repay debts. But even the most diligent borrower can run into unexpected setbacks – such as the temporary loss of a job, reduction in hours and income, unusual and non-recurring expenses like medical bills – that can threaten their ability to make their payments in a timely manner. The mortgage finance system should be organized to provide dependable, high quality service that is designed to maximize a consumer's chances to correct problems and overcome temporary setbacks. Where a positive outcome cannot be created, the system should provide a reliable and robust process through which loans can be resolved.

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Based on this paper's findings, and our work since 2009 on both federally-subsidized and private loan modification efforts, CFA recommends that Congress, the Consumer Financial Protection Bureau (CFPB), Federal Housing Finance Agency (FHFA) and other prudential regulators adopt uniform and binding requirements on servicers to assure that consumers are treated fairly and effectively if they run into problems paying their mortgages. While the scale of mortgage failures that followed the credit boom of the early 2000's is unlikely to be repeated in the near future, the crisis has illuminated many failings in the heretofore-standard servicing model that must be corrected to assure proper care even in "normal" times. Among other features, these standards should require the following:

1. A single point of contact (SPOC) for all borrowers through whom all communications between the servicer and the borrower will take place. The SPOC should manage the case from start to finish and have line responsibility for insuring that required actions are taken, materials delivered to consumers, and responses logged timely. The SPOC should have responsibility within the servicer to manage the consumer's case and assure that actions are taken timely and according to

established requirements.

2. Consumers should be offered substantive opportunities to modify their loans, instead of going through a foreclosure, based on an assessment of the relative net present value (NPV) of any modification – including short sales, deeds-in-lieu, and forbearance or forgiveness of principal.

3. The calculations used to determine this NPV test should be transparent, uniform and available for consumers and their advocates to review.

4. Servicers should be required to affirmatively reach out to borrowers who become delinquent and to insure they are fully aware of all the options that are available to them. Such notice should be provided promptly.
5. Servicers should be required to respond to consumer inquiries and submissions in a timely fashion.

6. Servicers should be required to complete *all* possible steps to modify a loan in order to help a borrower get back on track before being able to begin foreclosure proceedings against the borrower. The prevalence of so-called "dual tracking" of these two processes has led to too many tragic instances where homeowners struggling to obtain, make good on or complete a modification with the lender found themselves forced out of their homes nevertheless because of dual tracking that did not honor lender promises to stop short of foreclosure sales while modifications were under discussion.

7. Electronic portals and delivery systems should be required to provide a secure and trackable means through which consumers can communicate with servicers and deliver required materials.

8. Servicers should be required to engage consumer counseling organizations to assist in outreach, counseling and coaching for borrowers who become delinquent in their loans, and should compensate such agencies.

New servicing standards have been imposed through the settlement between state Attorneys General, HUD and DOJ with the five largest mortgage lenders, and the CFPB has proposed new rules that would apply across the financial services industry. CFA has joined other consumer and civil rights groups in commenting on the proposed CFPB rule.[1]

Introduction

The U.S. government has had a long tradition of supporting homeownership and encouraging Americans to aspire to owning their own home. Since 1986, mortgage interest has been the only interest payment that regular U.S. taxpayers can deduct from their income, along with property taxes and exclusions from capital gains taxes when a home is sold, a valuable subsidy. The government has supported homeownership finance through direct means, such as Federal Housing Administration (FHA) mortgage insurance, and indirect means, with institutions such as the Federal Home Loan Banks, Fannie Mae, and Freddie Mac, and regulatory initiatives such as the Community Reinvestment Act.

As a result of these policies and long periods of employment and income growth, the U.S. homeownership rate rose from the end of World War II from around 46 percent of all households to a high of 69 percent in 2004. However, these benefits were not equally enjoyed by all Americans. African-American homeownership rates in 1994 lagged those of White households by more than 25 percentage points, with the latter above 70 percent and the former only around 45 percent. Similar disparities applied to Hispanic- and Latino-American households. Both the Clinton and Bush Administrations adopted policy initiatives

[1] http://consumerfed.org/pdfs/Comments.AFRServicingLetter10.9.12.pdf

designed to help narrow this gap. Through financing initiatives, regulatory mandates on Fannie Mae and Freddie Mac, and other means, the Administrations and Congress tried to address the structural obstacles that often kept otherwise qualified minority Americans from qualifying for loans on the same terms as their White neighbors. Mortgage lenders and the secondary mortgage market adopted more flexible underwriting standards to help increase access to mortgage credit, invested in community outreach and homeownership counseling, and engaged nontraditional partners to reach traditionally underserved communities. And for a decade, these initiatives did help close the gaps, increasing African-American homeownership rates to nearly 50 percent, Hispanic rates to just over 50 percent, and overall homeownership to an all-time high of 69 percent.

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About 3.9 million foreclosures have occurred in the United States since 2007, and an additional 8-10 million mortgages are still threatened with foreclosure today—nearly one out of every five mortgages in existence today. These foreclosures have impacted Americans from every walk of life, from central city townhouse residents to owners of McMansions in the exurbs, from condominiums in South Florida to brand new tract homes in Southern California. African-American and Hispanic communities have been hit especially hard.

New homeowners, and some who cashed out equity in their homes through refinances, suddenly found themselves unable to pay their mortgages. Some failed because the terms of their loans included adjustable interest rates that ratcheted up faster than their ability to pay the higher charges. Others had overextended themselves in the rush to buy a home and taken on more debt than they could handle. Still others were displaced by the rapid rise in unemployment that followed the

financial crash of 2008. And in some markets, speculators were caught at the end of an ill-fated game of "musical chairs," owning properties they never had planned to occupy, but instead flip for a quick profit as home prices rose.

In response to this crisis, the Administration implemented a number of programs aimed at reducing foreclosures, helping troubled homeowners, and stabilizing housing markets. The Department of the Treasury, which is responsible for administering the Making Home Affordable (MHA) program, committed $75 billion in TARP funding and estimated that 3-4 million homeowners would avoid foreclosure through this program.

In its original form, MHA included two primary programs: the **Home Affordable Modification Program (HAMP)** and the **Home Affordable Refinance Program (HARP)**. (See Appendix 1 for a full list of MHA programs.) HAMP is an effort to induce servicers to modify troubled homeowners' mortgage loans to achieve more affordable payments, while HARP helps borrowers who owe more on their mortgage than their home is worth refinance into a lower-cost mortgage.[1]

The Administration based its approach on a few key principles:

- Aid should be directed to owner occupants, not investors.
- Borrowers should receive relief only if they were already in default or were in imminent danger of becoming so.
- The government would rely on private servicers to carry out the work, leaving the government to set policies and oversee their execution.
- Participation by lenders would be voluntary, and the government would encourage participation by offering to share in the costs of helping troubled borrowers.

- No lender would be asked to accept through a loan modification anything less than the fair, "net present value" of a home, meaning that the ultimate value of the modified loan must equal or exceed what the lender could receive through a foreclosure and sale.

As of October 2012, HAMP has helped nearly 1.3 million homeowners keep their homes by modifying their mortgages to more affordable levels, saving $16.2 billion in monthly mortgage payments. The Administration also claims credit for standardizing modification approaches through HAMP and encouraging a much larger number of so-called "proprietary modifications" carried out by lenders and servicers on their own. However, HAMP has not met the high expectations set at implementation. Recent modifications to the program hold some promise that many additional homeowners will be able to avoid foreclosure and stay in their homes. For instance, on January 27, 2012, program modifications were announced that greatly expand the parameters and extend the timeline for distressed homeowners. But the program's performance to date has disappointed many and made only a small impact on the larger mortgage crisis.

This report begins with a brief recounting of the mortgage foreclosure crisis. It then describes the HAMP program and its early problems, and policy changes that were implemented in reaction to those problems. The report describes the obstacles to greater use of the program and the concerns that prompted the most recent proposed program changes. Finally, it offers recommendations for how the program can serve more troubled homeowners.

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The Unfolding of the Foreclosure Crisis

The United States experienced an unprecedented real estate financing boom in the 2000s. Nationwide, housing prices increased substantially during the first half of the decade, with rampant speculation in some cities and regional areas. The Case-Schiller Home Price Index for the 20 largest metropolitan areas more than doubled from January 2000 until it peaked in July 2006.[2] In some markets, the run-up in housing prices was even greater. In the Los Angeles, San Diego, Las Vegas, and Washington, D.C., metropolitan areas, housing prices peaked in 2006 at two-and-a-half times their January 2000 level.

The run-up in prices was spurred on by easy access to mortgage credit as mortgage underwriting guidelines were excessively liberalized. The dollar value of mortgages taken out for home purchases more than doubled between 1997 and 2003.[3] New forms of mortgage lending that frequently combined various expansions of underwriting standards proliferated and nonprime lending—subprime and Alt-A loans—rose substantially during the early 2000s, eventually growing to 20 percent and 13 percent of the market, respectively, in 2006.[4]

Subprime loans and Alt-A provided investors with good returns at interest rates that were often five percentage points or more above prime.[5] Many subprime loans also tended to have low initial monthly payments that were fixed for two years and then adjusted to higher payments and interest rates for the rest of the loan. The Consumer Federation of America, examining lending in California, found that one-quarter of all fast-growing refinance loans were subprime, with 90 percent of them adjustable rate mortgages scheduled to reset to higher interest rates in two years.[6]

Alt-A loans usually required less documentation of creditworthiness or no documentation at all. These loans were originally created for the needs of small business owners, high net worth individuals and others with special circumstances. Many Alt-A loans also had a “pick-a-payment” feature: Borrowers could choose to make monthly payments

that did not even cover interest costs, with the unpaid-for interest tacked onto the principal. Thus, holders of Alt-A mortgages often saw their principal increase, an effect call "negative amortization." Many such borrowers were not always aware that their principal would rise.

In addition, many borrowers of these subprime and Alt-A mortgages carried second mortgages that were originated at the same time as the first mortgage, often used to reduce or eliminate the need for a down payment. These "piggyback" loans not only increased the odds of a foreclosure, but complicated the modification process as well. The Alt-A and piggyback mortgages were used, to a great extent, to increase "affordability," allowing people to purchase homes while home prices continued to increase to record levels. The Alt-A loans allowed borrowers to choose low monthly payments, or qualify with stated income or assets, while the piggybacked second mortgages kept down payments to a minimum.

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Much of the boom in subprime lending was for refinancing, often of prime mortgages with terms that were much more advantageous to the borrower. The resulting shift from stable, fixed rate mortgages to these new, less stable products meant that many borrowers were financed into a much riskier situation, with tragic consequences for them and their communities. Another significant portion of the lending in these new, non-prime loan products was for "moving up," from one home to another, usually more expensive, one. The easy credit that these new products represented helped fuel an otherwise unsustainable increase in home values that intensified the mortgage crisis once it began.

Lenders felt that these loans were viable, because they believed that home prices would continue to increase into the foreseeable future. Homebuyers also believed prices would continue on their upward trend. In fact, this collective belief in never-ending price increases fueled an asset-bubble mentality that dominated all parts of the home-buying industry, from the real estate professional and appraiser to the originator and securitizer.

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The use of these loan products was concentrated in certain markets, further fueling house price increases. For example, there was some concentration geographically in California, where prices were historically high, and in Florida, where prices were increasing dramatically.[7]

After examining more than a million home purchase and refinance loans, the CFA study found that Latino borrowers were twice as likely to get subprime loans for home purchase as were non-Hispanic White borrowers, and that African-Americans were two-and-a-half times as likely. Thus, subprime lending and the subsequent foreclosures that often followed were heavily concentrated in communities of color.

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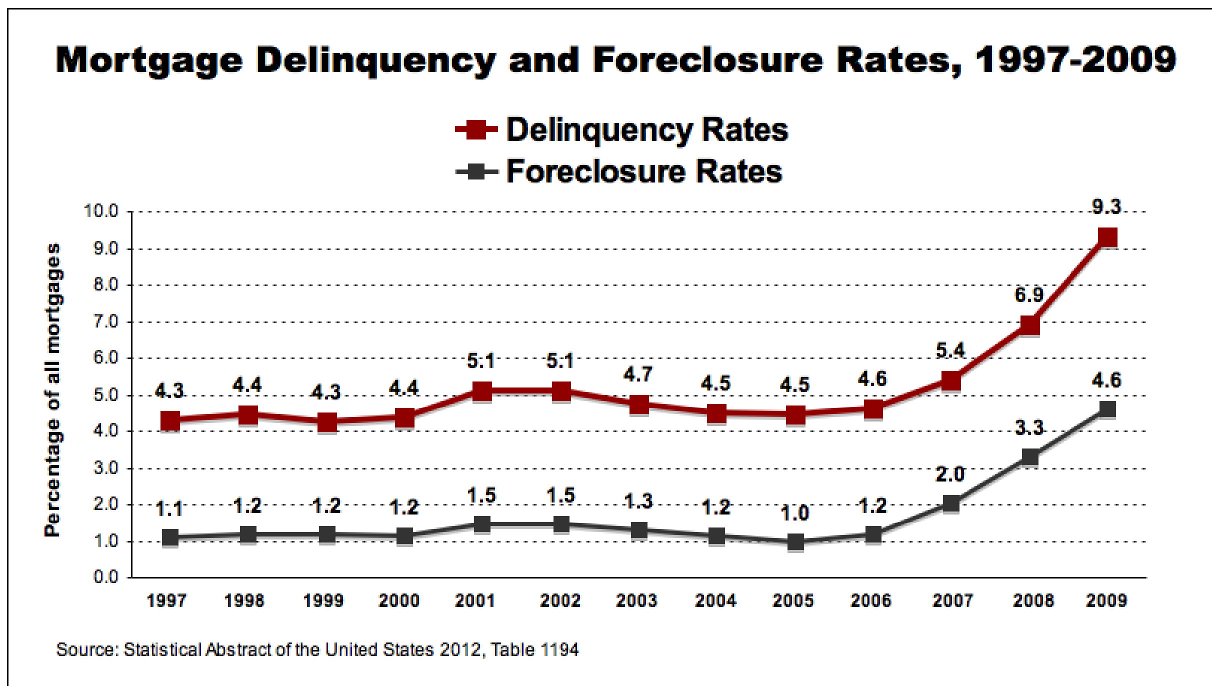
Compounding the problem as home prices rose over the period, homeowners began to refinance and take cash out of their homes at an even greater rate. The value of refinances increased ten-fold during that same seven-year period, reaching an amount that was more than twice the value of mortgages for home purchase. With home mortgage payments the only kind of interest that can be deducted for income tax purposes, rates significantly lower than credit card or payday lending options, a seemingly unending escalation in home prices, aggressive marketing by real estate and loan brokers touting the benefits of refinancing to take equity out of a home, and stagnant or falling real incomes for many middle-class families, some consumers turned to their homes to finance other consumer purchases and the daily costs of living.

Eventually, these higher-risk loans began performing poorly, having been made in many cases to borrowers who could not even make their payments at the initial teaser rates, much less the adjusted payments after two years. Delinquencies began to rise significantly in 2007, with serious delinquency rates doubling between 2006 and 2010, from 4.6 percent to 9.3 percent[8] (see Chart 1). By 2009, one in every four subprime loans was delinquent.

Foreclosures mirrored this climb over the same time period, with rates increasing from 1.0 percent in 2006 to 4.6 percent in 2010; for subprime loans, the rate was 15 percent.[9] Foreclosure rates have been significant enough to lower the national homeownership rate, which dropped from a peak of 69.0 percent in 2006 to 65.4 percent in 2012.[10] While the failures of "exploding ARMs" and unstable Alt-A mortgages were early drivers of the mortgage crisis, the rapid rise in unemployment that followed the financial collapse in 2007 quickly became a more sustained and intractable driver of mortgage failures, as collapsing home prices made selling or refinancing of existing home loans – a traditional means for distressed borrowers to resolve an inability to pay the mortgage -- impossible.

Chart 1



The foreclosure rate has risen nationally and in concentrated geographic hot spots. The so-called "sand states" (California, Florida, Arizona, and Nevada) have seen the most significant swings in housing prices and subsequently higher foreclosure rates than other states.[11] Foreclosure "starts" outside the sand states are disproportionally lower, with

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foreclosure starts in many states at less than one-third the rates found in the sand states.

Further, foreclosures also tend to be concentrated in low-income and minority communities. In 2010, the Joint Center for Housing Studies found that high foreclosure tracts (census tracts with a foreclosure rate of 10 percent or greater), had a substantially lower median income—$34,000—compared to $55,000 for tracts with lower foreclosure rates. Furthermore, the proportion of minority households was twice as large in high foreclosure tracts as the proportion in tracts with lower foreclosure rates, 66 percent vs. 33 percent.[12]

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Most loans from this period were not held by the lender that originated the mortgage, but instead were packaged into securities that were sold to investors. In those cases where the loans were not guaranteed by either Fannie Mae, Freddie Mac or FHA, these securities were divided into different levels of risk, or "tranches," which would determine how losses of principal were allocated when loans failed. These tranches were sold to investors with different goals – higher returns for taking more risk, low risk with substantial security against losses, etc. Many of these different tranches – especially the higher risk tranches -- were then rebundled into new securities that were sold to other investors; sometimes this was repeated more than once with each successive generation of securities. The subsequent administration of the loans (collecting payments, handling insurance and taxes, working with borrowers in default, and, if necessary, foreclosure and property disposition) is managed by mortgage servicers on behalf of the investors. The servicing rules for the securities not guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae were contained in specific "pooling and servicing" agreements (PSAs). These were not standardized and varied depending on the securities issuer. This widely dispersed ownership model, coupled with proprietary and non-standard servicing protocols, greatly complicated (and continues to complicate) the process of dealing with delinquent and defaulting borrowers.

Making Home Affordable:

Although the Troubled Asset Relief Program (TARP) originally was promoted when it was announced in 2008 as a means through which the U.S. government could ease the liquidity crisis following Lehman Brothers' collapse by buying securities and other assets, it was rapidly shifted to a program of investing capital directly into struggling private banking institutions. By early 2009, the Obama Administration initiated policies to carry out the TARP legislation's additional objective to help struggling homeowners. In March 2009, it announced that it was allocating $75 billion from TARP to Making Home Affordable (MHA), aiming to reduce struggling borrowers' first-lien monthly mortgage payments to a more affordable level, either through a modification (HAMP) or refinance (HARP). "Affordable" was defined as a mortgage payment that was 31 percent or less of the borrower's income.[13]

For HAMP, the more affordable payment is accomplished by modifying a loan through a combination of reducing the interest rate, extending the loan term, and forbearing on principal, or reducing the mortgage principal balance. The program relies on mortgage loan servicers to work with borrowers and make necessary changes to mortgages.

The criteria for HAMP eligibility at the time the program was announced were:

- The home had to be the borrower's primary residence;
- The amount owed on the first mortgage was less than $729,751;
- The borrower was having trouble paying due to financial hardship;
- The mortgage was originated before January 1, 2009; and
- Housing expenses (mortgage payment, taxes, insurance and homeowner's association fees) were greater than 31 percent of gross income.

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Homeowners who met these initial criteria were expected to establish communication with the mortgage servicer, who was then tasked with the collection of the required documentation for processing, loan modification, and decision making.

Four key features of the HAMP program are[14]:

1. **Cost Sharing**: Mortgage holders and investors are required to take the first layer of loss to reduce the monthly mortgage payment to 38 percent of the borrower's income. After that, the Treasury Department and the servicer each cover half the cost of bringing a loan from a 38 percent to a 31 percent debt-to-income ratio.

2. **Standardized Waterfall:** The servicer must follow a sequential modification formula to reduce the payment to 31 percent of income. Servicers must first capitalize accrued interest and certain expenses paid to third parties and add this to the principal. Then, interest rates are reduced until the target of 31 percent debt-to-income ratio is reached; however, the servicer cannot reduce interest rates below 2 percent. If the reduction to a 2 percent interest rate is not sufficient to reach the target ratio, then the servicer must extend the amortization period of the mortgage up to as much as 40 years. If debt-to-income is still above 31 percent, the servicer must forbear principal until the payment reaches 31 percent. In subsequent changes to the program, principal reduction was added to the waterfall.

3. **Standardized Net Present Value (NPV)**: If the expected investor's cash flow is expected to be greater with a modification than without one, the loan servicer is *required* to modify the loan. NPV is a calculation based on a variety of assumptions about the value expected to be derived from a foreclosure and sale of the property versus the value expected from modifying a mortgage. The purpose was to increase

investor awareness and confidence that a modification was ultimately in their best financial interest.

4. **Incentive Payments**: HAMP funds are used to provide initial and ongoing payments for up to five years to non-government-sponsored enterprise (GSE) loan servicers, mortgage investors, and borrowers to increase the likelihood of the success of the modified loan.

HAMP's incentive payments were important to the success of the program because they were the only real means applied to encourage servicer participation, although servicers who accepted TARP funds through other federal programs ultimately were required to participate in HAMP. Aside from federal cost-sharing to bring the monthly mortgage payment down, participating servicers also are entitled to receive an up-front payment of $1,000 for each permanent modification and additional payments of $1,000 for each of the next three years that the borrower successfully makes payments to stay in the program. Borrowers also were provided with incentives, receiving $1,000 for each of up to the first five years they make payments. Borrowers are required to demonstrate their ability to pay at the new rate by making payments during a 90-day trial period, after which a permanent loan modification is executed.

The incentive payments are critical to the success of HAMP because of the voluntary nature of servicer participation in HAMP. Servicers must sign a Servicer Participation Agreement (SPA) to join the program and agree to review the eligibility of any borrower who asks to be considered for a HAMP modification. By July 2009, 38 servicers had signed up for the program, representing 85 percent of the mortgages outstanding.[15]

The voluntary nature of HAMP also affected Treasury's decision making process in executing HAMP and other modification policies because of concern that servicers would pull out of the program if requirements were considered too onerous for servicers. Over time

Treasury improved many of its policies to require more of the servicers. But for their part, servicers criticized Treasury for the frequent modifications to HAMP for complicating their implementation process. In the end, the lack of adequate enforcement authority over the servicers is one of the most critical and enduring problems with the HAMP regime.

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The guaranteed investor cash flow and incentive payments were the carrot offered by Treasury to entice participation, but the only stick available to Treasury to address underperformers is public reporting of noncompliance and the option to withhold incentive payments.

In 2008, the Office of the Comptroller of the Currency (OCC) announced the tracking of performance of mortgage modifications in a Mortgage Metrics survey that captures information on 34 million of the approximately 55 million outstanding mortgages. The first report covered loan modifications from October 1, 2007, to March 2008, when only about 31,000 mortgages had been modified.[16] At that time, HAMP had not yet been implemented, and servicers were offering proprietary loan modification solutions. The most common loss mitigation tool was the payment plan—a short- to medium-term change in loan terms meant to give the borrower breathing room to recover economically and bring the loan current again—with 136,000 payment plans in place. The use of mortgage modifications had grown from less than 9,000 in November 2007 to more than 13,000 by March 2008. By the time HAMP was announced, servicers had increased the number of modifications to more than 60,000 per month.[17]

Nearly two-fifths of the 73 million children in the United States are from low-income families.

Treasury also entered into agreements with Fannie Mae and Freddie Mac to act as its financial agents for the HAMP program. Fannie Mae is the HAMP program administrator, developing and administering program operations, registering servicers, executing participation agreements, and collecting data. Freddie Mac is the HAMP compliance agent, responsible for assessing servicer compliance with program guidelines and conducting on-site and remote servicer reviews.

Early on, homeowners who received loan modifications had another problem to face: The Internal Revenue Service treated mortgage debt that was forgiven—whether after a foreclosure, short sale, or modification—as taxable income. Thus, many homeowners who received modifications to keep them from losing their homes were hit with tax bills they could not pay. The Mortgage Forgiveness and Debt Relief Act of 2007 (the Act) was enacted to protect homeowners from being taxed for the modification of a mortgage debt incurred for purchase or home improvement, but not if the loan was for debt consolidation or anything unrelated to purchase or improvement of the home. This act is currently scheduled to expire at the end of 2013. After the expiration of the Act, debt reduced through mortgage modifications or short sales will be considered as taxable income to the borrower. If the legislation is not extended, homeowners will be forced to complete a short sale or modification prior to year's end in order to avoid a tax consequence.[18]

HAMP's sister program, HARP, was aimed at helping homeowners who were "underwater" and therefore could not refinance. HARP is limited to borrowers who are current on their mortgage and to conforming mortgages held by the GSEs. HARP has two important objectives: first, to enable underwater performing borrowers to reap the benefits of historically low interest rates. Second, by enabling these reductions, HARP reduces the likelihood that these borrowers will default by lowering their payments.

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In addition to HAMP and HARP, two other programs were created in March 2009. The Second Lien Modification Program (2MP) was designed to help homeowners who are using a HAMP modification and have second mortgages on their properties. The Home Affordable Foreclosure Alternative (HAFA) was designed for those whose HAMP modification did not successfully stave off foreclosure. HAFA provides servicer incentives for short sales or deeds in lieu of foreclosure.

HAMP Early Performance

By July 2009, 1.4 million borrowers had requested information about the HAMP program, and 235,000 trial modifications had begun.[19] The majority of these trial modifications were serviced by JPMorgan Chase, Bank of America, Wells Fargo, and CitiMortgage. These four servicers were responsible for nearly two-thirds of the estimated number of eligible mortgages that were 60 or more days delinquent.[20]

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HAMP started slowly, but the number of trial modification rose to 1.3 million by June 2010, while 400,000 modifications had been made permanent.

However, HAMP implementation was beset by a number of problems from its onset. Reports by the Special Inspector General for TARP in March 2010[21] and the Government Accountability Office in June 2010[22] listed a number of implementation problems. These included:

- For nearly a year, Treasury did not issue guidelines for recruiting borrowers to the program, which resulted in inconsistencies in program implementation across servicers.
- Servicers were permitted to start trial modifications prior to receiving supporting documentation, particularly income verification, causing a backlog of trial modifications, many of which would never be made permanent.
- Servicers did not promptly respond to borrowers' submissions of their HAMP applications, with many homeowners spending months wondering about disposition of their modification requests.
- Treasury had done little to market the program to the public.
- No policy on the consequences of noncompliance with program requirements was issued, leaving Treasury in a weak position to enforce servicer compliance.

In addition, while Treasury emphasized the importance of reaching homeowners at risk of default as early as possible, no guidance on identifying these homeowners was provided. Servicers had a wide variety of methods for determining who was at risk of default, creating inconsistencies across servicers and confusion among homeowners as to whether or not it was necessary to intentionally miss two mortgage payments to be considered eligible for a HAMP modification.[23]

Other problems were created from the lack of specificity in Treasury guidance on how to implement the program, such as how to deal with customer complaints or how to conduct quality assurance reviews.

While Treasury was still establishing policies for HAMP implementation, servicers were struggling with how to increase activity in a segment of their operations that normally did not have significant resource demands. Prior to the foreclosure crisis, servicing focused primarily on collecting borrowers' monthly payments, bundling them, and sending them to the investors. Loss mitigation was a small aspect of a servicing operation and often little more than an extension of the servicer's collections department. The crisis caught Treasury policy-makers and servicers alike unprepared to deal with such widespread mortgage default, making early responses unproductive. For borrowers, this mismatch between servicer capacity and competency and the need for sensitive and effective mediation of a failing mortgage meant confusion, delay, and often led to foreclosures that should have been avoidable.

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Initially under HAMP, servicers were required to set up a trial modification plan for borrowers while the underlying documentation was being collected. After three months of making payments under the trial loan modification, the borrower was supposed to be given a permanent loan modification. However, many trial modifications were started without fully documenting whether or not the borrower's income would allow them to qualify for the program. Early on in the HAMP program, this problem contributed to a high failure rate in converting

borrowers to permanent modifications when it became clear that borrower incomes could not support the modified payments.

In June 2010, HAMP program guidelines were changed to require full documentation before starting the borrower's three-month trial payment period. Although this resulted in fewer borrowers qualifying for HAMP, this change contributed to a higher success rate for converting trial plans to permanent modifications.[24]

However, early on in the program very few homeowners who applied for the modification actually received one. For example, during fourth quarter of 2009, while 259,410 new HAMP trial modifications were initiated, only 21,316 trial modifications were converted to permanent modifications.[25] Subsequently, many of the homeowners who became delinquent in an effort to qualify for the program were foreclosed upon when no permanent modification was made. In her March 2012 Congressional testimony, Amherst Securities Managing Director Laurie Goodman noted that Treasury "counted" the modification from the moment it was initiated, yet many modifications failed in the first 3 months, increasing the failure rate of the modifications initiated in 2009.[26]

In addition, many homeowners who did receive HAMP modifications eventually re-defaulted. About 11 percent of the loans modified in the HAMP program in the fourth quarter of 2009 were 60 or more days (seriously) delinquent within six months of modification.[27] Defaults continued to rise as the modification matured, with 17 percent of HAMP modifications made in the first quarter of 2010 seriously delinquent after nine months, rising to 19 percent after 12 months.[28]

Even after the HAMP program got underway, it was still not the largest means through which borrowers got relief. Servicers were still doing more proprietary modifications than HAMP modifications, as well as other home retention actions. This may have resulted from servicers moving borrowers to proprietary alternatives after failing to qualify for a HAMP modification. Some lenders also may have diverted borrowers

to proprietary mods to avoid Treasury rules, and/or because of the changing terms of HAMP that increased the difficulty of servicer administration. During the fourth quarter of 2009, servicers outside of HAMP modified more than 100,000 mortgages and put an additional 120,000 on payment plans (short- to medium-term changes to rates and payments to get mortgages current).[29] Meanwhile, less than 21,000 HAMP modifications were made permanent that quarter, though nearly 100,000 trial modifications were initiated. By the end of 2009, more than 900,000 trial modifications had been started, and nearly 1.2 million trial plan offers had been made to borrowers.[30]

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Policy Modifications and Complements to HAMP

In time, Treasury made a number of policy changes aimed at improving the consistency of servicers' implementation and increasing uptake of borrowers' cases. (See Appendix 2 for a table of significant changes.) Treasury announced each of these changes (known as Supplemental Directives, or SDs) with varying levels of fanfare.

Of the more than 30 changes[31] to the HAMP program since its inception in April 2009, the first significant change was in October 2009. The Streamlined Borrower Evaluation Process (SD 09-07) was designed to streamline the program documentation requirements and standardize the evaluation process that servicers use to make a HAMP eligibility determination.

These October 2009 changes included the creation of a standard MHA Request for Modification and Affidavit form (RMA) that incorporates borrower income and expense information, a revised Hardship Affidavit, the SIGTARP fraud notice, conversion of the current HAMP Trial Period Plan so that the notice does not require a borrower signature, and standardized borrower response timeframes. These changes were considered so significant that they were put into effect immediately upon the directive's release.

In January 2010, Treasury announced Program Update and Resolution of Active Trial Modifications (Supplemental Directive 10-01). Effective June 2010, it represented the first time servicers were required to verify income before a trial modification would commence. The goal was to increase the number of trial modifications that would convert to permanent modifications. As of the end of May 2010, servicers had converted only 31 percent of eligible trial modifications to permanent modifications.[32]

In June 2010, Treasury rolled out the Principal Reduction Alternative, also known as PRA (Supplemental Directive 10-05), effective October 1, 2010, to alleviate the ongoing issue of borrowers with negative equity.[33] (See Appendix 1.)

PRA required servicers of non-GSE loans to evaluate the benefit of principal reduction for mortgages with loan-to-value ratios greater than 115 percent or when evaluating a homeowner for a first-lien modification. PRA pays servicers on a sliding scale for each dollar of principal forgiven, depending on how "underwater" the loan is. When a homeowner is left with more debt on their home than its current market value, the mortgage is called an "underwater mortgage." (See Glossary.) The deeper underwater the loan, the less HAMP pays for the principal reduced. The directive required lenders to run alternative waterfall analyses – both with principal reduction and without.

In addition, HAMP program update SD 10-01 included revisions to the 2MP program that require servicers to offer principal reduction on the borrower's second lien that corresponds to their HAMP first lien principal reduction.

Unfortunately, because PRA only covered non-GSE conforming mortgages, it only addressed a relatively small proportion of the at-risk loans. The July 2012 FHFA report[34] titled a "Review of Options Available for Underwater Borrowers and Principal Forgiveness" noted there were approximately 11.1 million underwater borrowers in the overall housing market at the end of 2011. However, Enterprise (Fannie

Mae or Freddie Mac) mortgages represent a little under half of the overall underwater population. As of the end of 2011, there were approximately 4.6 million underwater borrowers with Enterprise backed loans. Of those, 2.5 million have mortgages with current LTVs above 115 percent, and the remaining 2.1 million have mortgages with current LTVs between 100 and 115 percent.

In May 2011, Treasury directed the largest HAMP servicers to establish "relationship managers" who would provide a single point of contact for homeowners seeking a HAMP modification. Supplemental Directive 11-04 describes relationship managers as responsible for the relationship with the borrower throughout the entire default resolution process. Even if the loan is referred to foreclosure, the relationship manager must be available to respond to borrower inquiries regarding the status of the foreclosure. Even if this important change – pressed by advocates for many months before being adopted – has improved servicer communications with borrowers, there remains a general public belief that to apply for a HAMP modification means entering a maze of calls and lost paperwork.

Additional Initiatives Are Added to the Mix

In February 2010, frustrated with the lack of progress in the HAMP program and seeking a way to "jump start" modifications, Treasury announced the creation of the "Hardest Hit Fund." That program has provided $7.6 billion in funds by formula allocation to 18 states and the District of Columbia that have been most affected by the foreclosure crisis, based on a series of statistical tests. State housing finance agencies (HFAs) were invited to submit applications to use the funds in locally tailored programs to stabilize housing markets and prevent foreclosures. Like HAMP and other MHA programs, Hardest Hit Funds can be used for principal reduction to make monthly payments more affordable, mortgage payment assistance for unemployed or underemployed homeowners, payments to eliminate second liens, or to

help homeowners transition out of their homes to more affordable residences, usually rental properties.

However, this program has also suffered from implementation problems. The program sunsets at the end of 2017—but by the end of 2011, only $217 million, or 3 percent of budgeted funds, had been spent.

In August 2010, Treasury made the Emergency Homeowners Loan Program (EHLP) available to those states that were not included in the Hardest Hit Fund. The $1 billion program provided mortgage payment relief to eligible homeowners who had experienced a drop in income of at least 15 percent, directly resulting from involuntary unemployment or underemployment and/or a medical emergency. The mortgage relief could be used to cover past-due mortgage payments, as well as a portion of the homeowner's mortgage payment for up to 24 months. EHLP also ran into significant implementation problems, and the program ended after expending less than half the $1 billion allocated to it.

Servicer and Implementation Issues

In March 2011, GAO released another report on MHA that criticized Treasury for insufficient progress on improving HAMP.[35] The report cited continued problems with treating borrowers consistently and noted that Treasury had not established any specific remedies for program noncompliance. The report also stated that implementation of other programs established to complement HAMP—2MP, HAFA, and PRA—had been slow and that little activity in the programs had been reported. Further, a survey of housing counselors by GAO found that 76 percent characterized their experience with HAMP as either "negative" or "very negative."[36] Much of the criticism of the program was focused on the servicers, which often lost paperwork and responded to requests for trial modifications at a much slower rate—typically four months—than Treasury's 30-day guideline.

Another issue borrowers were having with servicers was the "dual tracking" of mortgages: pursuing both modifications and foreclosure proceedings at the same time. Numerous cases were reported of homeowners who, in the middle of working on a mortgage modification with their servicers, had their homes foreclosed on. Often, these two processes are handled by different parts of the servicers' operations which do not coordinate their efforts, allowing one branch to issue foreclosure papers while the other is reviewing modification documents. The government acted to keep dual tracking out of the HAMP program, announcing as part of Supplemental Director 10-02 that servicers cannot refer a mortgage for foreclosure until its eligibility for HAMP has been determined and that they must halt foreclosure proceedings once a homeowner begins a trial modification.[37] While this curtailed the practice of dual tracking for mortgages being modified through HAMP, dual tracking has continued for other borrowers. Some states have outlawed the practice, including California, where in July of 2012 Governor Jerry Brown signed legislation that requires servicers to give a yes or no answer on loan modification before they can proceed with the foreclosure.[38] In June 2011, Treasury announced it would withhold incentive payments from three of the largest servicers—Bank of America, JPMorgan Chase, and Wells Fargo—because of poor performance in implementing HAMP, particularly for the need to improve methods for evaluating homeowner income requirements.

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<u>What Worked: Making Better Modifications</u>

The primary reason for the better performance of HAMP loan modifications compared with earlier versions of proprietary modifications was that they tended to provide greater payment relief to the borrower. Also, principal reduction or forbearance was used more often in HAMP modifications than in proprietary loan modifications. Initially, nearly all (96 percent) HAMP modifications provided for capitalization of fees and missed payments, and reduction of interest rates; about half the modifications included term extensions; and about one-quarter included principal deferral.[39] As the program matured,

principal forbearance and principal reduction became more common methods for making mortgages affordable. In the fourth quarter of 2011, capitalization of fees and missed payments continued to be the most common method applied, while interest rate reductions dropped to 89 percent. However, principal deferral was used in 39 percent of HAMP modifications, and the use of principal reduction increased to 16 percent of all HAMP modifications.[40] Non-HAMP modifications with principal reduction increased to a high of 6 percent by third quarter 2011, but dropped to 4 percent by the fourth quarter.[41] However, the more than 2.5 million non-HAMP modifications still are more than double HAMP's almost 1 million modifications.

While smaller in volume, HAMP modifications have performed better than proprietary modifications. During the first quarter of 2010, 19 percent of first HAMP modifications eventually became seriously delinquent, while 34 percent of non-HAMP modifications became seriously delinquent.[42] Although the performance gap between HAMP and non-HAMP loans has varied over time, HAMP modifications typically had lower serious delinquencies than non-HAMP modifications by about 10 percentage points.

The two primary factors affecting post-modification performance to avoid re-default appear to be the amount that the monthly payment was reduced and the time period when the loan was refinanced. During every period examined, when monthly payments were reduced by 20 percent or more, those loan modifications far outperformed those with lower or no reductions.[43] As seen in the table below, re-default rates were lower with greater reductions in monthly payments and when done in more recent years. The exception is on loans that saw no payment changes, which outperform all modifications except those with the highest level of reduction. These mortgages tend to be those in which the interest rate was frozen on an adjustable rate mortgage so that the rate and payment do not increase—a type of modification most often offered to borrowers who are current on their mortgages.[44]

The two primary factors affecting post-modification performance to avoid re-default appear to be the amount that the monthly payment was reduced and the time period when the loan was refinanced

Table 1: HAMP and Non-HAMP Re-default Rates After Nine Months, by Monthly Payment Change and Year of Modification

Year Modified: **<u>Amount Changed</u>**	**2008**	**2009**	**2010**	**2011**
Reduced 20% +	33.4%	25.1%	15.0%	15.0%
Reduced 10-20%	41.6%	37.3%	26.3%	26.0%
Reduced < 10%	50.3%	42.6%	33.5%	29.4%
No Change	62.5%	55.1%	23.8%	16.0%
Increase	63.8%	55.9%	40.4%	44.1%

Source: OCC Mortgage Metrics Report Fourth Quarter 2011.

When comparing the status of HAMP modifications to non-HAMP modifications at the end of the fourth quarter of 2011, 51 percent of non-HAMP modifications were current, compared to 66 percent of HAMP modified mortgages. Further, 13 percent of non-HAMP modified loans were in the foreclosure process or had completed foreclosure, compared to only 7 percent of HAMP modifications.[45] For either HAMP or non-HAMP modifications, reducing the monthly payment rate by less than 10 percent made it twice as likely for the loan to be in the foreclosure process or already foreclosed than if the monthly rate were reduced by more than 10 percent.

HAMP servicer participants must first evaluate a borrower under HAMP guidelines. However, if a borrower does not meet HAMP requirements, borrowers may be aided through the proprietary programs lenders also offer.

Most Recent Changes to HAMP and HARP

On January 27, 2012, the Obama Administration announced further significant changes to the HAMP program. First, eligibility was expanded, allowing homeowners with debt-to-income levels (including non-mortgage debts) below 31 percent to participate. Eligibility was also extended to non-owner-occupants, reflecting the greater importance now being placed on market stabilization relative to the policy concerns that investors should not receive assistance. Finally, the Administration tripled incentive payments for principal reduction and expanded incentives to include Fannie Mae and Freddie Mac and encourage the GSEs to allow principal reduction on the mortgages they hold.

To date, the GSEs have not followed suit, and FHFA[46], the companies' conservator, has vigorously opposed efforts to include principal write-downs in the GSE loan modification toolkit.[47] In July 2012, FHFA director DeMarco announced that the Enterprises would not be participating in the principal reduction alternative. The FHFA report states:

> *Existing Enterprise loss mitigation efforts provide opportunities for all types of underwater borrowers. For borrowers who have the ability and willingness to pay there is HARP, which as the result of recent changes has been helping an increasing number of underwater borrowers. For borrowers who do not have the ability but do have the willingness to pay, both HAMP and the Enterprises' proprietary modifications provide at least as much monthly payment relief as HAMP PRA. Finally, for borrowers who do not have the ability or willingness to pay, the Enterprises' foreclosure alternatives, either through short sales or deed-in-lieu of foreclosure, provide an opportunity to exit their home without the harm to their credit standing that foreclosure produces.*
>
> *In terms of the Enterprises' adopting HAMP PRA, once the impact of strategic modifiers and the operational costs and*

> *complexity of implementing HAMP PRA were fully considered, the results of the model-driven analysis were insufficient to warrant the Enterprises participation in HAMP PRA.* [48]

Just prior to the changes made to the HAMP program, the Administration also took steps to revitalize the HARP program by unveiling a series of revisions collectively known as HARP 2.0. Announced in October 2011, the HARP 2.0 changes seek to remove many of the obstacles underwater borrowers faced in earlier versions of HARP. The program is expected to help thousands of underwater borrowers lower their monthly house payments; HARP 2.0 has the potential to succeed. The previous version of the program did not allow refinances for borrowers who owed more than 125% of what their homes were worth. That cap on mortgage loan to value stood as a major obstacle to thousands of borrowers whose homes plunged in value. HARP 2.0 removes that cap.

HARP 2.0 also releases the lender's liability for representations and warranties it made on the original loan. Lenders had argued that without such relief, they faced significant additional liability for any failure of the new loan, in spite of the fact that nothing material would change except making the terms more affordable to the borrower. In addition, HARP 2.0 also releases lenders that refinance a loan originally serviced by a different lender from new rep and warrant liability, within certain limits.

With the previous version of HARP, many homeowners complained that lenders wouldn't refinance more than 105% of a home's value, even though the program's cap was 125%. Some feared lenders would adopt a similar policy for HARP 2.0. But three of the largest lenders—Bank of America, Chase, and Wells Fargo—say they have removed the cap and are willing to refinance according to the HARP 2.0 new guidelines.

There is evidence that the HARP 2.0 changes and the FHFA directives executing its changes for the GSEs have sparked an uptick in refinance

applications. Nevertheless, consumers report significant delays in completing the refinance process, and there is some evidence that lenders are taking advantage of this demand by raising fees and reducing the net benefit that consumers could obtain through these and higher rates.[49]

Current State of Mortgage Modifications

As of October, 2012, the latest MHA report states that about 1 million homeowners have received HAMP first lien mortgage modifications, reducing their monthly mortgage payments by a total of $5.7 billion annually.[50] On average, these homeowners are saving about $541 per month, approximately one-third of their pre-modification payment. The second lien program (2MP) and HAFA have served 80,000 and 44,000 homeowners, respectively, bringing the MHA total for assisting borrowers to more than 1.1 million actions. Also, 86 percent of those entering a HAMP modification after June 2010 received a permanent modification, a significant improvement over early performance.[51] Monthly trial starts, while declining in number throughout most of 2011, have been holding steady since January 2012.[52]

As of the end of 2011, HAMP had spent only $1.8 billion of the $50 billion[53] budgeted, though it had allocated $19.1 billion based on expected payouts to borrowers receiving modifications.[54] Further, Treasury had expended only $8.8 million for the Principal Reduction Alternative (PRA) Modification program, and $100 million for each of 2MP and HAFA. In total, MHA had expended only $2.3 billion as of December 2011.

Across all loan modification platforms, more than 5.9 million modification arrangements were started between April 2009 and March 2012, including more than 1.8 million HAMP modification starts and 1.3 million FHA loss mitigation and early delinquency interventions, with the remaining being proprietary mortgages offered by servicers.[55] Taking advantage of low interest rates, 14.7 million homeowners since April 2009 have refinanced their mortgage, helping to make their

mortgages more affordable and allowing homeowners to save an estimated $30 billion annually from modifications and refinances.[56]

The continuing toll inflicted by economic problems, particularly lingering high unemployment, is still telling. In May 2012, 67% of homeowners with active permanent modifications had experienced a loss of income due to unemployment or curtailment of income,[57] up from 61% in May 2011[58] and 60.3% in May 2010.[59] Re-default rates on HAMP permanent modifications continue to grow as they age. However, Administration reporting continues to show improvements in performance for more recent modifications, which underscores the importance of reducing monthly payments sufficiently to ensure the long-term success of a loan modification. Nearly half of HAMP modifications with a less than 20 percent reduction in monthly payments are 60 days delinquent.

Administration reporting continues to show improvements in performance for more recent modifications, which underscores the importance of reducing monthly payments sufficiently to ensure the long-term success of a loan modification.

Despite some improvement in the economy, mortgage delinquencies are persisting at historically high levels. In the third quarter of 2004, the Mortgage Bankers Association's National Delinquency Survey put less than 2 percent of mortgages in the "seriously delinquent" category, compared to 7.4 percent in that category in the first quarter of 2012, albeit down from over 9 percent in 2009.[60]

Taking Aim at Fraudulent Foreclosures

While mortgage delinquencies remain historically high, foreclosures are beginning to taper off. At the end of 2011, the number of newly initiated foreclosures had decreased by 16.0 percent from the previous quarter and 17.9 percent a year earlier.[61] The decrease in new foreclosures at least partly reflects the continued emphasis on home retention actions, including HAMP modifications and payment plans, while another significant factor is the delays in foreclosure actions caused by the consolidated lawsuit filed against the major servicers by HUD, DOJ and state attorneys general. Following the settlement of that suit, foreclosure actions are likely to tick up again.

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Regardless, servicers are *completing* foreclosures at a greater rate, with the number of completed foreclosures increasing by 22.1 percent from a year earlier.[62] Servicers are still applying alternatives to foreclosure, having initiated 460,000 new home retention actions—loan modifications, trial-period plans, and payment plans—during the fourth quarter of 2011, but this represents a decline of more than 3 percent from the same quarter in 2010.[63]

Federal and state governments have also targeted fraudulent foreclosure practices. In March 2011, after many months of negotiation, 49 state attorneys general and the federal government reached agreement on a $25 billion joint state-federal settlement with the country's five largest loan servicers: Ally/GMAC, Bank of America, Citi, JPMorgan Chase, and Wells Fargo.

The settlement provides for as much as $25 billion in relief to distressed borrowers in the states that signed on to the settlement, and direct payments to signing states and the federal government. The agreement settles state and federal investigations finding that the country's five largest loan servicers routinely signed foreclosure-related documents ("robo-signing") outside the presence of a notary public and without really knowing whether the facts they contained were correct—practices that violate the law.

The settlement provides benefits to borrowers in the signing states whose loans are owned by the settling banks as well as to many of the borrowers whose loans they service. Borrowers from Oklahoma will not be eligible for any of the relief, however, because Oklahoma elected not to join the settlement.

In addition, on April 13, 2011, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision announced enforcement actions against 14 large residential mortgage servicers and two third-party vendors for unsafe and unsound practices related to residential mortgage servicing and foreclosure processing. As part of those consent orders, federal

regulators required servicers to engage independent firms to conduct a multifaceted review of foreclosure actions in process in 2009 and 2010. This is also known as the Independent Foreclosure Review (IFR). Under the orders, independent consultants are charged with evaluating whether borrowers suffered financial injury through errors, misrepresentations, or other deficiencies in foreclosure practices and determining appropriate remediation for those customers. Where a borrower suffered financial injury as a result of such practices, the agencies' orders require financial remediation to be provided.

Despite these latest trends and enforcement actions, the foreclosure crisis is far from over. There will be years more of high foreclosure rates and millions of homes lost before mortgage performance returns to historical norms. Laurie Goodman of Amherst Securities, an expert who regularly testifies before Congress, predicts that more than 10 million of the mortgages now outstanding will fail eventually.[64] With a total of 55 million mortgages currently active, this represents nearly one borrower in every five.

Conclusions and Recommendations

HAMP has helped nearly a million homeowners stave off foreclosure and keep their homes. The program has also helped standardize and improve the performance of proprietary mortgage modifications, assisting many more homeowners. The less well-publicized HARP program has helped an additional 1.6 million homeowners refinance their mortgage payments to more affordable levels.[65]

Early optimistic projections for assisting homeowners have not been met, however. There were many early implementation problems, as Treasury launched the program before putting all the necessary policies in place, causing inconsistencies in how criteria were applied, a slow response to those seeking help, and high re-default rates early in the program. The success of the program also depended greatly on the cooperation, and to some extent the enthusiasm, of mortgage servicers. Mortgage servicing divisions were overwhelmed and were slow to

switch gears away from operations whose primary business had always been processing payments and paying investors, to a different mindset involving customer relations and development of loan modification processes that more closely aligned with the functions of an origination and underwriting department. While it had long been the quietest part of the service industry, loss mitigation suddenly was front-page news.

Another issue is the complications caused by second liens that were present on many mortgages, particularly Alt-A mortgages originated in the boom. Amherst Securites' Laurie Goodman has testified before Congress repeatedly on the problem the industry faced when loss mitigation was performed by servicers despite the inherent conflict of interest when they own the second lien on the same property but service both the first and second lien.[66]

The Administration's Making Home Affordable program did not provide sufficient motivation for mortgage servicers to ramp up more quickly to adopt more effective loss mitigation processes and approaches.

The Administration's Making Home Affordable program did not provide sufficient motivation for mortgage servicers to ramp up more quickly to adopt more effective loss mitigation processes and approaches. The program offered servicers too many positive incentives and not enough penalties, in part because there is no legal basis to force a bank to modify a loan. The decision of whether to modify or foreclose a loan was based on net present value calculations designed to ensure that servicers would not lose more money with the modifications than they would with the foreclosure. The opacity of these calculations before Treasury made them public and standardized them was a major irritant in the program's early days, and led to concerns that economically sensible modifications had not always been carried out. In addition, servicers were paid incentives for each modification. However, other than appearing on the MHA list for insufficient compliance or having incentive payments temporarily withheld, there were no consequences for servicers who did not comply, and there were none for not being more proactive.

By the end of 2010, half of all trial modifications had been canceled. At that time, there were more foreclosure starts than modifications.

However, program improvements were adopted as Treasury identified problem areas and more homeowners in trial payment plans successfully moved to permanent modifications. Servicers became more compliant with program requirements andre-default rates dropped significantly. The number of HAMP modifications has stopped declining, and the changes made to HAMP in January 2012 have the potential to open the program up to many more homeowners.

But for many borrowers, it is too late. They have been foreclosed upon while waiting for a decision, or gave up on government programs after having submitted too many documents too many times, only to be turned down or find out they were lost. The number of new trial modifications dropped each month from March to December 2011, but has held steady since. There are millions of Americans who still face the threat of foreclosure, and many millions more who will likely fall behind on their payments because of the continuing weak economy. Amherst Securities Managing Director Laurie Goodman has testified before Congress she calculates that on the current course out of 52.5 million total U.S. homes with a mortgage, 14.1-17.7 % (or 7.4-9.3 million) of these borrower face foreclosure and "eventual liquidation."[67]

HAMP is still needed and should be extended beyond the end of 2013. The mortgage crisis is far from over; with more than 400,000 foreclosure starts in the last quarter, extending HAMP is still critical. In addition, the Mortgage Relief Act of 2007, which prevents "gains" from modifications from being taxed, should be extended before its current expiration in December 2012.

Conclusion Summary:

1. The CFPB and FHFA should move quickly to establish clear guidelines for mortgage servicing that will forbid dual tracking of modifications and foreclosure actions, require servicers to modify loans, designate a single point of contact for borrowers.
2. Servicing compensation practices should be revised to place a higher premium on adequate funding to manage delinquent

loans more speedily and comprehensively that was the case prior to 2007. Flat compensation schemes in which there are no reserves or surplus revenue booked to finance the more complex and expensive tasks involved in a loan modification should be changed. Servicers should not have financial incentives to earn fees from repeated modifications or from extended delinquencies.

3. Financial regulators should place a much heavier emphasis in their safety and soundness examinations on lenders' servicing capabilities. The crisis has made it clear that weak mortgage modification capacities exacerbate losses, harm consumers and can cause extensive property and community devaluations.
4. Pooling and servicing agreements governing private label securitizations should be standardized and include clear directions to servicers to act in the borrowers' best interests in carrying out loan modifications. The lack of such standards meant confusion, delays and inequitable treatment of borrowers based solely on the securitization trust in which their loan happened to land.
5. Important legislative measures that should be championed by consumer groups include: the extension of the Mortgage Forgiveness and Debt Relief Act of 2007 (expiring at the end of 2013); and HAMP, HARP and all the other government programs (see Appendix 2) are still needed and should be extended beyond the end of 2013.

Appendix 1: Making Home Affordable: Federal Programs to Date[68]

Program Name	Announced/ Effective Date	Description
Home Affordable Modification Program **(HAMP)** **SD 09-01**	Announced: March 2009 Effective: March 4, 2009 Revised: (see Appendix 2) Sunset: December 31, 2013 (extended from 2012)	Reduces monthly mortgage payment for at-risk but employed homeowners to no more than 31 % if gross monthly income (Debt to Income). At- risk homeowners is defined as those undergoing financial hardship and are either delinquent or in danger of falling behind on their mortgage. Reduces rate with a floor of 2% and if necessary extending term or amortization to 40-year term max. No min or max LTV but must be conforming mortgage. Homeowners with high DTI required to enter consumer debt counseling program Includes homeowner incentives for up to $1,000 principal reduction for timely payments.

Home Affordable Refinance Program **(HARP)** SD 09-01	Announced: March 2009 Effective: March 4, 2009 Revised: December 2011 Sunset: December 31, 2013	For non-delinquent homeowners with Fannie Mae or Freddie Mac owned- mortgage including those whose current loan-to-value ratios are above 80%. Borrower must be current on mortgage payments for prior 12 month period. HARP began with 105% LTV limit but program revised to 125% LTV limit on 7/1/09; again 3/10, and LTV limit removed 12/11.
FHA-HAMP	Announced: July 30, 2009 Effective: August 15, 2009 Revised: *Jan/Feb 2012* Sunset: December 31, 2013	Borrowers with FHA-insured mortgages can do a FHA- to-FHA streamlined refinancing without a full re-underwrite of the loan. Borrowers can reduce their mortgage payments into monthly mortgage payments that are no more than 31 percent of their verified monthly gross (pre-tax). 2012 revision: To reduce the number of FHA borrowers who have not been approved due to FHA lender concerns about compromising their status as FHA-approved lenders, FHA removed FHA-HAMP loans from FHA's "Compare Ratio". This evaluation is part of the process by which the performance of FHA lenders is reviewed. *Back end ratio (DTI) must not exceed 55%.*

USDA Special Loan Servicing	Announced: August 26, 2010 Effective: September 24, 2010 Revised: February 2012 Sunset:	Rural homeowners whose loans are insured by the United States Department of Agriculture's (USDA) Section 502 Single Family Housing Guaranteed Loan Program, are eligible for refinancing into monthly mortgage payments that are no more than 31 percent of their verified monthly gross (pre-tax). Feb 2012 revision eliminates the requirement for a new appraisal, a new credit report and other documentation normally required in a refinancing. Single Family Housing Guaranteed Rural Refinance Pilot Program runs for 2 years in 19 states. Eligible borrowers must be in default or must be looking at imminent default *(verify)*
Veteran's Administration Home Affordable Modification (VA-HAMP)	Announced: January 8, 2010 Effective: February 1, 2010; revised May 24, 2010 Sunset:	At-risk borrowers with loans insured or guaranteed by the Department of Veterans Affairs (VA) may be eligible for VA program to lower monthly mortgage payment to 31 percent of verified monthly gross (pre-tax) income.
FHA Second Lien Program (FHA2LP)	Announced: August 6, 2010 Effective: September 7, 2010 Sunset:	For FHA mortgage holders with a second mortgage. If FHA Short Refinance, borrower may be eligible to have their second mortgage on the same home reduced or eliminated through the **FHA Second Lien Program (FHA2LP)**. If the second mortgage servicer agrees to participate, the total amount of mortgage debt after the refinance cannot exceed 115 percent of home's current value.
FHA Refinance of Borrowers with Negative Equity Positions (FHA Short Refinance)	Announced: March 26, 2010 Effective: September 7, 2010 Sunset:	Allows non-delinquent homeowners, who owe more than home's current value, to refinance into a FHA-insured mortgage. If participating lenders approves the FHA refinance, lender is required to reduce the amount owed on the first mortgage to no more than 97.75 percent of home's current value. Loan cannot be owned or guaranteed by Fannie Mae, Freddie Mac, FHA, VA or USDA. Borrower's total debt must not exceed 55 percent of monthly gross income.

Program Name	Announced/ Effective Date	Description
FHA Refinance of Borrowers with Negative Equity Positions (FHA Short Refinance)	Announced: March 26, 2010 Effective: September 7, 2010 Sunset:	Allows non-delinquent homeowners, who owe more than home's current value, to refinance into a FHA-insured mortgage. If participating lenders approves the FHA refinance, lender is required to reduce the amount owed on the first mortgage to no more than 97.75 percent of home's current value. Loan cannot be owned or guaranteed by Fannie Mae, Freddie Mac, FHA, VA or USDA. Borrower's total debt must not exceed 55 percent of monthly gross income.
Hardest Hit Fund (HHF)	Announced: February 2010 Effective: Revised: August 2010 ($2 billion added) Sunset: 2017	State-run program for 18 states/and D.C. **Programs vary state to state, but may include[69]:** • Mortgage payment assistance for unemployed or underemployed homeowners • Principal reduction • Funding to eliminate homeowners' second lien loans • Help for homeowners who are transitioning out of their homes and into more affordable places of residence.
HUD Emergency Homeowners Loan Program (EHLP)	Announced: August 2010 Effective: Extended: July 2011 Sunset: Expired (July 27, 2011)	Designed to complement Treasury's Hardest Hit Fund by providing assistance to unemployed/underemployed homeowners in hard hit local areas that *were not included* in the Hardest Hit target states[70]. The program utilized a variety of state/ nonprofit entities to offer a declining balance, deferred payment "bridge loan" (zero percent interest, non-recourse, subordinate loan) for up to $50,000 to assist eligible borrowers with payments on their PITI for up to 24 months. Borrowers had to be at least three months delinquent in their payments and have a reasonable likelihood of repayment of their mortgage payments and related housing expenses within two years.

Appendix 2: Summary Table of Significant U.S. Treasury

HAMP Supplemental Directives to Date[2]

Issue Date	Effective Date	SD Title	SD Description	SD Number
April 6, 2009	April 6, 2009	Introduction to the Home Affordable Modification Program	Introduces HAMP, HARP, 2MP and HAFA	09-01
October 8, 2009	October 8, 2009 March 1, 2010	Streamlined Borrower Evaluation Process	Streamlines the program documentation requirements and standardizes the evaluation process that servicers use to make a HAMP eligibility determination. Creates standard MHA Request for Modification and Affidavit form (RMA) that incorporates borrower income and expense information, a revised Hardship Affidavit, and SIGTARP fraud notice. Converts the current HAMP Trial Period Plan so that the notice does not require a borrower signature; and standardizes borrower response timeframes.	09-07
January 28, 2010	June 1, 2010	HAMP--Program Update and Resolution of Active Trial Modifications	Requires servicer verify income before trial modification commences and included revisions to the 2MP program that require servicers to offer principal reduction on the borrower's second lien that corresponds to their HAMP first lien principal reduction.	10-01
June 3, 2010	October 1, 2010	Modifications of Loans with Principal Reduction Alternative (PRA)	Provides alternative modification waterfall to perfrom NPV evaluation and financial incentives for principal reduction. On 2MP *requires* principal reduction be at least proportional to principal reduction on corresponding HAMP modified first lien mortgage loan.	10-05
May 18, 2011	September 1, 2011	Single Point of Contact	Servicer must designate a single ('same') relationship manager to manage the borrower relationship throughout the entire delinquency or imminent default resolution process, including any home retention and non-foreclosure liquidation options, and, if the loan is subsequently referred to foreclosure, must be available to respond to borrower inquiries regarding the status of the foreclosure (by 11-1-2011).	11-04

[2] The MHA Handbook is a consolidated reference guide outlining the requirements and guidelines for the Making Home Affordable (MHA) Program for non-GSE mortgages. The current version of the MHA Handbook is 3.4 and replaces and supersedes all Supplemental Directives (SDs), related frequently asked questions (FAQs) and waivers, with the exception of SD 11-11, 11-12, 12-01, 12-02 and 12-03

Issue Date	Effective Date	SD Title	SD Description	SD Number
March 3, 2012	June 1, 2012	Making Home Affordable Program – MHA Extension and Expansion	**Expands HAMP eligibility** to allow borrowers whose mortgage payments were below 31 % of their incomes to qualify[3]. More flexible DTI approach that takes other debt into account when calculating DTI ratios. **Expands HAMP to rental properties** from owner-occupied homes to tenant-occupied properties. **Triple balance-reduction incentives:** Increases incentives (ranging from18 cents and 63 cents) for every dollar that lenders take off the mortgage principal[4] **Fannie and Freddie principal reduction incentives** [5] expanded to Fannie Mae or Freddie Mac if they allow servicers to forgive principal in conjunction with a HAMP modification. **Expiration:** extends the deadline for eligibility in MHA and all of its component programs (from 12/2012) through December 31, 2013.	12-02
August 7, 2012	August 7, 2012	Making Home Affordable Program – Administrative Clarifications	**Administrative HAMP Clarifications** • Prescreening Borrowers • Imminent Default • Multiple Modifications • Continued Eligibility and Change in Circumstance • Protections Against Unnecessary Foreclosure • Underwriting • NPV and Modification Waterfalls	12-05
November 30, 2012	November 30, 2012	Making Home Affordable Program – Administrative Clarifications	**Administrative HAMP Clarifications:** • HAMP Modified Loans Repurchased from GSEs • Debt-to-Income Ratio Eligibility	12-09

[3] Originally HAMP designed to bring mortgage payment to flat 31% of income.
[4]Original lender incentive was between 6 cents and 21 cents.
[5] GSEs not required to comply and FHFA announces its final decision not to participate in principal reduction incentives in FHFA paper *"Review of Options Available for Underwater borrowers and Principal Forgiveness"* July 31,2012. http://www.fhfa.gov/webfiles/24108/PF_FHFApaper73112.pdf

[1] The Administration received many recommendations for how to intervene in the mortgage crisis. These often called for much more aggressive steps than were actually taken. See, for instance, *Retooling HUD*, March, 2009, University of Pennsylvania Institute for Urban Research, at http://penniur.upenn.edu/uploads/media_items/retooling-hud-report.original.pdf.

[2] Standard and Poor's Case-Schiller Index. http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices.

[3] Statistical Abstract of the United States, 2011, Table 1193.

[4] Joint Center for Housing Studies, *State of the Nation's Housing 2008*, Author's analysis of Appendix Table A-6.

[5] For a discussion of the rise of subprime lending and an analysis of the business model, see *The Rise of Subprime Lending: Causes, Implications, and Proposals, Barry Zigas, Paul Weech and Carol Parry, April, 2002, Fannie Mae White paper.*

[6] Consumer Federation of America, *Piggy Back Loans at the Trough: California Subprime Home Purchase and Refinance Lending in 2006*. January 2008.

[7] At the same time there was also a significant run-up of subprime lending in low-income minority communities. Consumer Federation of America's (CFA) report on subprime lending in California found that minorities were much more likely to get subprime loans than were non-Hispanic white borrowers. After examining more than a million home purchase and refinance loans, the CFA study found that Latino borrowers were twice as likely to get subprime loans for home purchase as were non-Hispanic white borrowers, and that African-Americans were two-and-a-half times as likely. Thus, subprime lending and the subsequent foreclosures that often followed were heavily concentrated in communities of color. These loans, especially Alt-A loans, were increasingly used as "affordability" tools to qualify borrowers for homes whose prices were rising more quickly than incomes. Lenders were overly relying, foolishly as it turned out, on rising home prices as a hedge against the resets on 2/28 ARM loans. The collective asset bubble mentality was a big driver of some of these bad loans and bad underwriting, and exacerbated the resolution of failed mortgages when so many of these loans turned out to be upside down.

[8] Statistical Abstract of the United States, 2012, Table 1194.

[9] Ibid.

[10] U.S. Census, *Residential Vacancies and Homeownership in the First Quarter 2012.* April 2012.

[11] U.S. Department of Housing and Urban Development. *Report to Congress on the Root Causes of the Foreclosure Crisis.* January 2010.

[12] Joint Center for Housing Studies, *State of the Nation's Housing 2011*. Appendix Table A-6.

[13] Government Accountability Office, *Troubled Asset Relief Program*, GAO-11-338T, March 2011.

[14] Government Accountability Office, *Troubled Asset Relief Program*, GAO-10-634, June 2010.

[15] U.S. Department of Treasury, *Making Home Affordable Program, Data through July 2009*.

[18] *Homeowners Still Need Protection from Tax Consequences of Loan Modifications*. Letter to Senate and House leaders from Consumer Federation of America, et al. http://www.consumerfed.org/elements/www.consumerfed.org/file/housing/Tax_Letter_Final.pdf.

[20] Servicers had been providing mortgage modifications prior to the onset of HAMP. OCC has tracked the performance of the mortgage market and mortgage modifications by reviewing 34 million of the approximately 55 million mortgages on the market. In the OCC's first report, covering mortgages up to March 2008, only about 31,000 mortgages had been modified.[20] The most common loss mitigation tool used at that time was the payment plan, a short- to medium-term change in loan terms meant to get the borrower current again, with 136,000 plans in place at that time. The use of mortgage modification had been growing at this time, from less than 9,000 in November 2007 to more than 13,000 by March 2008. By the time HAMP was announced, servicers had increased the number of modifications to more than 60,000 per month.[20]

[21] Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), *Factors Affecting Implementation of the Home Affordable Modification Program.* March 2010.

[22] Government Accountability Office, *Troubled Asset Relief Program*, GAO-10-634, June 2010.

[23] Ibid.

[24] Another early concern about HAMP was that, in order to qualify, homeowners needed to demonstrate "financial hardship," which came to be defined as being delinquent on a mortgage. However, this criterion for eligibility was not explicitly delineated in the original policy. Thus, even if a borrower was facing an imminent increase in their mortgage payment, the borrower was facing a job loss, or the borrower was clearly on the way to becoming delinquent, homeowners were not considered eligible for HAMP until they were late on payments. Some anecdotal evidence suggests that many homeowners deliberately chose to miss payments in order to be eligible for a HAMP modification.

[25] OCC, *Mortgage Metrics,* Fourth Quarter 2009 Report.

[26] March 15 2012,Testimony of Laurie Goodman, Amherst Securities Group, to the Senate Banking Committee's Subcommittee on Housing, Transportation and Community Development. http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=0f96e0ff-8500-41a5-a0f2-0139d0df2e07

[27]OCC, *Mortgage Metrics,* Fourth Quarter 2009 Report. Table 32.

[28] *Mortgage Metrics*, Fourth Quarter 2010 Table 31 and Second Quarter 2011, Table 32.

[29] *Mortgage Metrics*, Second Quarter 2010, Table 14.

[30] U.S. Department of Treasury, *Making Home Affordable Program, Data Through December 2009.*

[31]List of HAMP SDs on http://www.nclc.org/home-affordable-modification-program-hamp/hamp-supplemental-directives.html.
[32] Government Accountability Office, Troubled Asset Relief Program, GAO-10-634, June 2010.
[33] See Appendix 1.
[34] FHFA, *Review of Options available for Underwater Borrowers and Principal Forgiveness.* July 2012
[35] U.S. Government Accountability Office, *Troubled Asset Relief Program: Actions Needed by Treasury to Address Challenges Implementing Making Home Affordable Programs*. GAO-11-338T. March 2, 2011.
[36] U.S. Government Accountability Office, *Results of Housing Counselors Survey on Borrowers' Experience with Home Affordable Modification Program*. GAO-11-367R, May 26, 2011.
[37] *Stopping Foreclosures amid Mortgage Modifications*, Center for American Progress, Peter Swire, November 19, 2010. http://www.americanprogress.org/issues/2010/11/stopping_foreclosures.html
[38] *Governor Brown Signs Landmark Foreclosure Legislation into Law*, California Progress Report. July 11, 2012. http://www.californiaprogressreport.com/site/governor-jerry-brown-signs-landmark-foreclosure-legislation-law
[39] *Mortgage Metrics*, Fourth Quarter 2009.
[40] *Mortgage Metrics*, Fourth Quarter 2011.
[41] Author's analysis of *Mortgage Metrics*, Fourth Quarter 2011, Tables 13, 17 and 18.
[42] *Mortgage Metrics*, Second Quarter 2011, Table 32.
[43] *Mortgage Metrics*, Fourth Quarter 2011, Tables 33, 34, 35 and 36.
[44] Ibid, page 41.
[45] Ibid, Table 38.
[46] http://www.fhfa.gov/webfiles/23876/Brookings_Institution_-_Principal_Forgiveness_v11R-_final.pdf. DeMarco's comments on principal forgiveness at Brookings Institution on April 10, 2012
[47] FHFA's Acting Director Edward J. DeMarco has argued that the GSEs' use of principal forbearance, coupled with acceptance of short sale proceeds in the event of a foreclosure or legitimate borrower need to sell, such as for new employment, provides a better balance between homeowner benefit and taxpayer cost, because the companies are dependent on significant amounts of Treasury capital investments to meet their obligations.
[48] FHFA paper *"Review of Options Available for Underwater borrowers and Principal Forgiveness"* July 31,2012. http://www.fhfa.gov/webfiles/24108/PF_FHFApaper73112.pdf
[49] "Borrowers Face Big Delays in Refinancing Mortgages," Nick Timaraos and Ruth Simon, *Wall Street Journal*, May 9, 2012; http://online.wsj.com/article/SB10001424052702303459004577364102737025584.html?KEYWORDS=Refinances.
[50] Department of the Treasury, *Making Home Affordable Report, Data Through 3Q 2012, October 2012 National Scorecard*
[51] U.S. Department of Housing and Urban Development/U.S. Department of the Treasury. *The Obama Administration's Efforts to Stabilize the Housing Market and Help American Homeowners.* April 2012.
[52] Department of the Treasury, *Making Home Affordable Report, Data Through March 2012.*

[53] There was originally a budget of $75 billion for HAMPl. $50b from TARP and $25b from the GSEs in their modifications.
[54] Special Inspector General for the Troubled Asset Relief Program. *Quarterly Report to Congress*. January 2012.
[55] U.S. Department of Housing and Urban Development/U.S. Department of the Treasury. *The Obama Administration's Efforts to Stabilize the Housing Market and Help American Homeowners.* April 2012.
[56] Ibid.
[57] U.S. Department of Treasury, Making Home Affordable: Program Performance Report Through May 2012, page 6.
[58] U.S. Department of Treasury, Making Home Affordable: Program Performance Report Through May 2011, page 5.
[59] U.S. Department of Treasury, Making Home Affordable: Servicer Performance Report Through May 2010, page 3.
[60] Mortgage Bankers Association, National Delinquency Survey; Third Quarter 2004 and press release: National Delinquency Survey, May 2012.
[61] Mortgage Metrics, Fourth Quarter 2011.
[62] This increasing pace of completions is partly a result of the national settlement with lenders announced in 2012 that will enable lenders who were under scrutiny by the U.S. Department of Justice, HUD, and state attorneys general to move forward on completing foreclosure actions that were tainted by false notarizations and "robo-signing" of documents.
[63] Ibid.
[64] October 26 2011 Testimony of Laurie Goodman, Amherst Securities Group to the Subcommittee on Insurance, Housing and Community Opportunity of the U.S. House of Representatives, Committee on Financial Services.
[65] *The Obama Administration's Efforts to Stablize the Housing Market and Help American Homeowners,* HUD and the Department of the Treasury, October, 2012
[66]

http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=0f96e0ff-8500-41a5-a0f2-0139d0df2e07 Laurie Goodman, Amherst Securities, testimony to Senate Banking Subcommittee on Housing, Transportation, and Community Development on March 15, 2012. page 3.

[67]ibid . page 1.

[68] Encompasses all loans originated on or before January 1, 2009. In addition, all loans must be conforming mortgages (equal or less than $729,750) and owner-occupied unless otherwise stated. Borrowers cannot have been convicted within the last 10 years of felony larceny, theft, fraud or forgery, money laundering or tax evasion, in connection with a mortgage or real estate transaction. Borrower must

have sufficient, documented income to support the modified payment. Full list of terms ***of all above foreclosure programs is on U. S Treasury site:*** *http://www.makinghomeaffordable.gov/programs/view-all-programs/Pages/default.aspx*

[69] Hardest Hit Fund (HHF) states funded by $7. 6 billion U.S. Treasury 18 states/and D.C include**.**: Alabama, Arizona, California, Florida, Georgia Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, Tennessee, and Washington D.C.

[70] EHLP was available in the following states: Alaska, Arkansas, Colorado, Hawaii, Iowa, Kansas, Louisiana, Maine, Massachusetts, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Mexico, New York, North Dakota, Oklahoma, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming, as well as Puerto Rico. HUD also identified five states — Connecticut, Delaware, Idaho, Maryland, and Pennsylvania — operating their own respective mortgage assistance programs that met HUD's criteria as "substantially similar" to the EHLP. Each of these states received direct allocations of EHLP funds to directly administer and assist homeowners in need through their own programs.