LOAN MODIFICATIONS: "Making Home Affordable" Work

By Angelyque Campbell

While the national economy is moving toward recovery and there are signs of life coming back to the housing market, measures to help the millions of homeowners at risk of foreclosure seems to have had only a modest impact. The persistent increase in unemployment will continue to drive foreclosures upward.[1]

The Obama Administration aims to keep 7 to 9 million families in their homes through a broad set of loan modification strategies under its Making Home Affordable (MHA) program. To respond to the widespread default rates among mortgage borrowers, the Department of Treasury, tasked with executing MHA, has created a framework to handle modifications at scale.

With concerns mounting over servicers' efficiency and responsiveness to borrowers, MHA and its principle loan modification program, HAMP (Home Affordable Modification Program), are under pressure to perform. This article provides a brief chronology of federal efforts that led to MHA with particular attention to adjustments made to HAMP to improve mortgage affordability. Several policy changes that are likely to impact the success of MHA will also be examined.

Overview of Loan Modification Programs

One early federal response to the sharp increases in foreclosures came with the creation of HOPE NOW, an alliance between the government, mortgage industry and housing counselors. This collaboration was intended to develop a variety of strategies to help distressed borrowers, including solutions to ease temporary financial hardships such as forbearance and repayment plans. Shortly afterward, the Department of Housing and Urban Development (HUD) launched an enhanced version of its refinance program called FHASecure, aimed at providing relief from rate resets to creditworthy borrowers. These efforts failed to address the significant debt of distressed homeowners and the negative equity position they faced because of falling home prices.

One year later, the Hope for Homeowners program was included in the Housing and Economic Recovery Act (HERA) of 2008. This new program, administered through HUD's Federal Housing Administration (FHA), set eligibility criteria for refinancing from high-cost loans to 30-year, fixed-rate mortgages. This program was intended to serve the victims of predatory lending as well as homeowners financially "underwater" in their homes.[2] In exchange for significant, low-cost refinancing, the program allotted a share of the home's future appreciation to FHA. This program resulted in only 34 refinancings[3] despite growing numbers of households facing foreclosure. As HUD officials later acknowledged in congressional testimony, the program was thwarted by several obstacles to participation, including steep borrower fees and an inflexible and complex program design.[4]

In February 2009, the number of foreclosures completed grew 67 percent over the prior month, hitting a new monthly high.[5] During this time, President Barack Obama announced his first housing initiative, Making Home Affordable. The program intended to give mortgage servicers both a simple framework and financial inducements to help families avoid foreclosure by restructuring or refinancing their mortgages. As of September 2009, 63 servicers, which represent approximately 85 percent of the mortgage market, had signed participation agreements indicating their willingness to modify loans under the program's terms.[6] Less than a month later, the U.S. Department of Treasury launched, as part of MHA, the Home Affordable Modification Program (HAMP), which spelled out basic loan modification criteria. HAMP required that monthly payments on first-lien mortgages be reduced to no more than 31 percent of a homeowner's monthly gross income.

This affordability requirement had been developed by the Federal Deposit Insurance Corporation (FDIC) and first applied in August 2008 to distressed loans held by failed lender, IndyMac. The FDIC, which had taken over IndyMac, developed a modification package that limited a borrower's debt-to-income ratio to no more than 38 percent. This package was intended to achieve affordable, sustainable loan modifications that could be reproduced on a large scale and serve as an industry model.

Similar to the IndyMac loan modification program, a key feature of HAMP is a trial period that tests a borrower's ability to make a modified loan payment. Servicers offer this trial modification to help distinguish between borrowers who can and cannot afford to maintain their homes. Under HAMP, the borrower must stay current on a modified mortgage payment over a three-month period before the modification plan is finalized. The Treasury Department's first HAMP performance report, issued in July 2009, showed 235,247 trial modifications had been initiated.[7] The most recent report (September 2009) shows approximately 487,081 trial loan modifications in progress.[8]

Since the creation of HAMP, Treasury has announced four additional HAMP subprograms:

Home Price Decline Protection (HPDP) encourages loan modifications in markets hit hardest by falling home prices. Investors in mortgage-backed securities receive incentive payments for HAMP loan modifications on properties where home prices have declined or significant sale price declines are likely. The incentive payment is "linked to the rate of recent home price decline in a local housing market, as well as the unpaid principal balance and mark-to-market, loan-to-value ratio of the mortgage loan."[9] Mortgage loans owned or guaranteed by Fannie Mae or Freddie Mac are eligible for HPDP incentive payments.

The ***Second Lien Modification Program (2MP)*** is designed to work in tandem with HAMP to provide greater mortgage affordability. Under 2MP, when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, the second-lien servicer must offer to either modify the borrower's second lien under program guidelines or extinguish the entire second lien in exchange for a lump-sum payment from Treasury.[10]

Additional terms/features of the 2MP program include the following:

- No additional verification of the financial information provided by the borrower used in the determination for the first HAMP modification;
- Required trial periods; and
- Use of a technology program to match first and second liens across participating HAMP servicers, and if a match is found, a requirement to offer the borrower a second-lien modification.

Data Collection and Reporting Requirements Guidance includes periodic reporting of servicers' HAMP loan level data to Fannie Mae, the HAMP program administrator. Data variables include loan identifiers and borrower characteristics such as race, ethnicity and gender.[11]

FIGURE 1

Home Affordable Modification Program (HAMP)

Snapshot through August 2009

Number of Trial Modifications Started (Cumulative)	360,165
Number of Trial Period Plan Offers Extended to Borrowers (Cumulative)	571,354
Number of Requests for Financial Information Sent to Borrowers (Cumulative)	1,883,108

Source: Making Home Affordable Program Servicer Performance Report through August 2009. Survey data provided by servicers. The trial modifications start when the first trial payment is received.

The ***Streamlined Borrower Evaluation Process*** addresses the inconsistent processing and slow response times of servicers. The Treasury now provides servicers with a standardized form to collect borrower income and expense information, and it permits more simplified income documentation and verification requirements, such as verbal financial information obtained from the borrower to assess eligibility for a trial modification plan.[12]

The ***FHA-HAMP*** assists FHA mortgagors in default. When initially introduced, MHA did not include FHA loans. This program now gives FHA authority to combine a loan modification with a partial claim for its foreclosure-related costs (e.g., legal fees) and principal reductions up to 30 percent of the unpaid principal balance as of the date of default. The FHA borrower is also subject to MHA's trial modification period and front-end debt-to-income ratio of 31 percent to determine eligibility for a permanent loan modification.

The ***Foreclosures Alternative Program*** offers investors additional cash incentives to accept a short sale or deed-in-lieu of foreclosure from borrowers who are unlikely to afford a modified mortgage.

Hope for Homeowners Refinancing strengthened Hope for Homeowners with additional incentive payments for servicers and lenders who provide sustainable refinance loans under Hope for Homeowners program criteria. Servicers can receive a $2,500 up-front incentive payment for each successful Hope for Homeowners refinancing. Lenders who originate Hope for Homeowners refinances also are eligible for incentive payments of up to $1,000 per year (for up to three years) for each refinanced loan as long as the loan remains current.

Barriers to Success

The issues of affordability, scale and pace remain central to policy discussions on the effectiveness of loan modification programs. The Senate Committee on Banking, Housing and Urban Affairs held a hearing on July 16, 2009, to examine the impact of federal measures to stem the foreclosure tide and explore ways to make these initiatives more effective. This hearing revealed both an array of obstacles to the success of federal intervention efforts and potential strategies to strengthen federal foreclosure prevention programs.

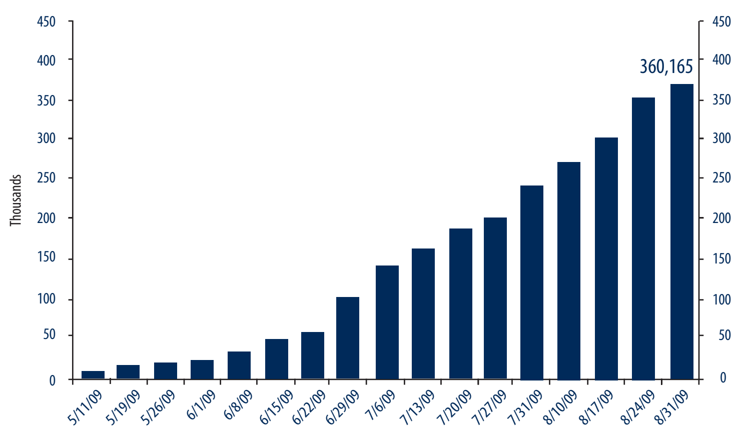
At the time of the hearing, participants acknowledged that HAMP was a new program but also identified the following weaknesses:

- Housing counseling groups asserted that many loan work-outs require principal reductions to make monthly mortgage payments sustainable.
- Housing counselors argued that encumbrances on a homeowner's ability to build equity diminish the wealth-building opportunities of homeownership and can be a disincentive for homeowners to sustain a modified loan.
- Even if principal reductions are mandated, neither program eliminates negative

FIGURE 2

Home Affordable Modifications Started (Cumulative)

Snapshot through August 2009



Source: Making Home Affordable Program Servicer Performance Report through August 2009.

equity, a problem Paul Willen, senior economist and policy advisor at the Federal Reserve Bank of Boston, contends that along with job loss " will persist even after the economy recovers."[13]

- Servicers argued that net present value calculations on first liens did not fairly compensate holders of second liens.
- Servicers expressed doubt that the Administration's goal of helping 7 to 9 million homeowners could be reached because HAMP excludes loans guaranteed through the Veterans Administration or FHA and also excludes borrowers approved for refinancing.
- Consumer advocates claimed loan servicers were noncompliant with HAMP guidelines. They cited refusals to offer HAMP modifications when they are indicated, inadequate staffing levels, slow response times and lack of transparency in documentation and reporting. (Servicers responded that program restrictions and multiple versions of program guidelines impede their compliance.)

The Treasury's Responses

It may still be too soon to assess the effectiveness of MHA—servicer guidance was issued on April 6, 2009, and only two Treasury performance reports have followed. Treasury's recent issuance of additional guidance, mentioned above, is an attempt to address program shortcomings. Lowering the debt-to-income ratio to 31 percent to make monthly mortgage payments more affordable was a significant step forward, particularly at a time of double-digit unemployment rates that result in a decrease or loss of income for many homeowners. HAMP's "pay-for-success" structure, which better aligns with the interests of servicers, investors and borrowers, increases the likelihood of more sustainable, affordable, cost-effective loan modifications.

Standardized guidelines are expected to encourage efficient processing and may yield greater numbers of modifications. The inclusion of Hope for Homeowners and FHA into the HAMP framework will also help to achieve a more consistent and uniform approach among servicers' modifications. The creation of a second-lien program should remove existing barriers to modifying first-lien loans encumbered by a second mortgage that stood to lose any chance of recovery after modification of the first mortgage.

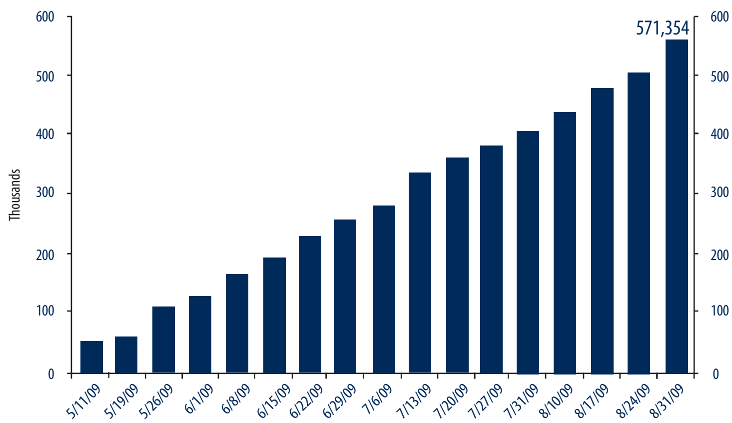
Factors Critical to Success

A July 2009 Government Accountability Office report also stressed the need for mechanisms promoting transparency, accountability, enforcement and compliance of HAMP.[14] Regular public progress reports by servicers toward meeting stated loan modification goals can bring accountability to a process still largely dependent on voluntary private sector participation. Second reviews by Freddie Mac of servicers' underwriting decisions on some loans serve as additional monitoring. Reporting reasons for denied loan modification will also provide needed scrutiny to ensure that evaluation processes comply with HAMP guidelines and fair lending laws.

One measure suggested to promote rapid responses from lenders and servicers to borrowers is the creation or retooling of automated platforms. As pointed out at the Senate Banking Hearing by Joan Carty of the Housing Development Fund, such a system would advance the preferred action of borrowers proactively contacting their servicer when facing risk of default rather than refusing assistance until default happens, thus subjecting the borrower to

FIGURE 3

Home Affordable Modification Plans Extended to Borrowers (Cumulative)



Source: Making Home Affordable Program Servicer Performance Report through August 2009.

adverse credit reporting.[15] Enhanced automation tools would also reduce the risk of lost files and paperwork, a common complaint raised by housing counselors and borrowers as the reason for lengthy processing times.

The other critical factor to HAMP's success is the conversion of borrowers from trial modification status to permanent status. The increasing number of borrowers participating in trial plans demonstrates, in part, that the right incentives and program structure can help to avert, even if temporarily, the loss of homes. Going forward, keeping borrowers in their homes at affordable mortgage loans brings needed stability to neighborhoods and other business sectors dependent on a healthy housing market. Local governments also benefit from an increase in revenue stream from affordable mortgage loans.

Adaptability is Key

As housing and employment conditions change, it is imperative that the Treasury continue to closely monitor, reevaluate, and be ready to re-tool HAMP. Some consider the Administration's goal to save nearly 10 million families from foreclosure unachievable. However, collaborative efforts closely tuned to market conditions and in keeping with proven strategies will give the Make Home Affordable initiative its best possible chance of meeting or exceeding its goal.

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Note: It should be noted that program guidelines reflects data from July–October, 2009. For recent program updates to HAMP, please visit Treasury's HAMP website for servicers at **www.hmpadmin.com**.

Endnotes

[1] Board of Governors of the Federal Reserve System. "Monetary Policy Report to Congress." July 21, 2009.

[2] "Underwater" is a common term used to describe when what is owed on a home exceeds the property's current market value.

[3] U.S. Department of Housing and Urban Development, Computerized Home Underwriting Management System. October 2009 report.

[4] Testimony of Dave Stevens, Assistant Secretary for Housing and FHA Commissioner, HUD, delivered at the hearing before the Sub-committee on Housing and Community Development, U.S. House Committee on Financial Services. September 9, 2009. **www.hud.gov/offices/cir/test090909.cfm**

[5] Making Home Affordable Program Servicer Performance Report through August 2009. **www.MakingHomeAffordable.gov**

[6] U.S. Department of Treasury, "Making Home Affordable Program: Service Performance Report through September 2009." **www.financialstability.gov/docs/HAMP/MHA%20Public%20100809%20Final.pdf**

[7] U.S. Department of Treasury, "Making Home Affordable Program: Service Performance Report through July 2009." **www.treas.gov/press/releases/docs/MHA_public_report.pdf**
[8] U.S. Department of Treasury, "Making Home Affordable Program: Service Performance Report through September 2009." **www.financialstability.gov/docs/HAMP/MHA%20Public%20100809%20Final.pdf**
[9] Treasury Supplemental Directive 09-04, July 31, 2009. **www.hmpadmin.com//portal/docs/hamp_servicer/sd0904.pdf**
[10] Treasury Supplemental Directive 09-05, August 31, 2009. **www.hmpadmin.com//portal/docs/second_lien/sd0905.pdf**
[11] Treasury Supplemental Directive 09-06, September 11, 2009. **www.hmpadmin.com//portal/docs/hamp_servicer/sd0906.pdf**
[12] Treasury Supplemental Directive 09-07, October 8, 2009. **www.hmpadmin.com//portal/docs/hamp_servicer/sd0907.pdf**
[13] Testimony of Paul S. Willen, Federal Reserve Bank of Boston before the U.S. Senate Committee on Banking, Housing, & Urban Affairs Hearing on "Preserving Homeownership: Progress Needed to Prevent Foreclosures." July 16, 2009.
[14] United States Government Accountability Office, Report to Congressional Committees. "Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable." July 2009.
[15] Testimony of Joan Carty, The Housing Development Fund before the U.S. Senate Committee on Banking, Housing, & Urban Affairs Hearing on "Preserving Homeownership: Progress Needed to Prevent Foreclosures." July 16, 2009.