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Foreclosure Crisis and Response: How Homeowners Fared in Reaching Out for Mortgage Assistance

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Community
Scope

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Foreclosure Crisis and Response: How Homeowners Fared in Reaching Out for Mortgage Assistance

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"We would love to keep our home - it is much more than just a house to us, but, at this time, it looks as if we may lose one of the most important things in our life, the one thing we have worked so hard on."

– April 2010 Foreclosure Prevention Event Attendee

Since 2009, close to 75,000 U.S. homeowners have attended homeowner outreach events in an attempt to prevent the loss of their house through foreclosure.[1] In the early part of the foreclosure crisis, subprime borrowers with resetting adjustable rate mortgages (ARMs) received a lot of attention.[2] As the Great Recession progressed, prime borrowers, the majority of whom had fixed rate mortgages, were caught up in the crisis through job loss as well as negative housing equity. The number of foreclosure starts in the U.S. increased from 800,000 in 2006 to a record high of 2.4 million in 2009.[3] Millions of homeowners were now behind on their monthly mortgage payments. The scale of the problem raised concerns about the stability of neighborhoods and the overall U.S. housing market.

To address the growing crisis, in February 2009, the federal government announced the Making Home Affordable (MHA) initiative, which through its various programs offered incentives to mortgage companies to provide mortgage relief to homeowners. The goal of mortgage relief was to "reduce the amount homeowners owe per month to sustainable levels", so they could stay in their houses.[4] MHA

Introduction

was initially intended to help as many as 3 to 4 million homeowners by the end of 2012.[5] To date, the initiative has spent $6.5 billion dollars with roughly 1.8 million homeowner assistance actions taken.[6]

This issue of *Community Scope* describes the mortgage outcomes for homeowners who sought assistance with their mortgage difficulties. Our description is supplemented by findings from our surveys of homeowners who attended foreclosure prevention events between 2009 and 2010.[7] The experiences of these homeowners give insight into their circumstances and whether mortgage assistance can be effective in helping homeowners avoid foreclosure.

Background

In December 2007, the U.S. entered its worst recession since the Great Depression of the 1930s. There was a substantial increase in mortgage delinquencies. The number of delinquent mortgages in the U.S. doubled from 2.3 million in 2006 to 4.6 million in 2009.[8] Housing prices declined nationwide. The median price for a one unit, non-condo residential property in the U.S. fell from $222,075 in 2006 to $178,550 in 2009.[9] Declining house prices impacted the values of owner-occupied houses, so that by the end of 1st quarter 2009, a third of mortgaged properties across the U.S. had negative equity.[10] The economic downturn left millions unemployed. For the week of May 30, 2009, there were 6.6 million continued claims for unemployment insurance and 612,000 new claims.[11] Given this difficult economic environment, a majority of delinquent homeowners could trace their mortgage hardship to a combination of adverse shocks and negative equity.[12]

An adverse shock is an unexpected negative event in someone's life. Adverse shocks typically affect a household's income or expenses making it difficult for the homeowner to pay their mortgage. Income loss can stem from a change in the number of income earners in a household for various reasons such as divorce, death, a health condition or unemployment. At the end of 2009, U.S. Treasury officials reported that among homeowners who received a permanent modification through the MHA initiative, 57.4 percent suffered from loss of income (curtailment of income or unemployment), 11.2 percent from excessive obligation, and 2.7 percent from illness of the principal borrower.[13] Four years later, borrowers' mortgage hardship reasons have remained the same. As of August 2013, the breakdown among homeowners with a MHA-related permanent modification was 68.3 percent experienced loss of income (curtailment of income or unemployment), 10.4 percent excessive obligation and 3.5 percent illness.[14]

In a healthy housing market, it may be possible for homeowners who have experienced an adverse shock to sell their house, move to more affordable housing and keep the difference between the sales price and the amount owed on the mortgage. However, negative equity changes this calculation.[15] Negative equity means that the homeowner's house is worth less than the amount they owe on their mortgage.

Credit: Federal Reserve Bank of Richmond

Assistance

As a result, even if they were able to sell their house, they would end up owing the mortgage company the difference between the sales price and the remaining loan amount, compounding their financial difficulties. While some homeowners may "walk away" from their homes under these circumstances, others may want to negotiate with their servicers in an attempt to remain in their house. This usually involves renegotiating certain terms of the original mortgage contract.

"We have lived here for 30 years."

– April 2010 Event Attendee

Homeowners may initiate mortgage negotiations for various reasons, ranging from personal to financial. For some, their house is more than its physical structure; for many, it has been their place of residence for a substantial number of years. Financially, a foreclosure results in a substantial decline in the borrower's credit rating from which it may take several years to recover.[16] Such renegotiations between the homeowner and their mortgage company became a key tool in the federal government's foreclosure prevention efforts.

"Servicer does not want to own this house and will put it on the market as soon as possible. My family and I on the other hand, wants [sic] this house. I know that I am the only person who wants [Address] just as it is, because it stayed on the market for seven months before we purchased it. I had invested time, effort, love and money into this house to make it a home for me and my family. I only ask, on behalf of me and my family that we be given the opportunity and allow us to keep our home we so desperately want."

– August 2009 Event Attendee

Government Intervention

The federal government's efforts to prevent foreclosures were aimed at "working homeowners who have made every possible effort to stay current on their mortgage payments."[17] It encouraged leading organizations with a role in the mortgage market to join forces and to assist troubled homeowners. One of the results of this alliance between housing counselors, mortgage companies, investors and other groups was foreclosure prevention events where homeowners had the opportunity to meet one-on-one with their mortgage companies to try to resolve their mortgage issues. The record number of homeowners experiencing mortgage trouble made it difficult for homeowners to reach their servicer over the phone to initiate renegotiations. The events provided another forum to establish contact. They were usually organized and held at convention centers or sports arenas across the nation. The MHA initiative asked servicers to send letters to delinquent homeowners telling them about an event taking place nearby and encouraging them to attend. In the early years of the foreclosure crisis, the news media reported on the long lines of homeowners that stretched for multiple city blocks waiting to enter one of these events.

At these events, homeowners had the opportunity to learn whether they qualified for one of the programs under the MHA initiative. Some of these programs had financial incentives for servicers, investors and homeowners to encourage positive renegotiations. For example, under the Home Affordable Modification Program (HAMP), a servicer would receive a $1,000 for each completed loan modification and then receive an additional annual amount for three years if the renegotiated loan remained in good standing.[18] The federal government hoped that these financial incentives would induce servicers to renegotiate with an expanded pool of troubled homeowners.

"Reviewed our situation and said we made too much money so they would not work with us."

– August 2009 Event Attendee

Outcome

Homeowners waiting for the doors to open (top) and meeting with their servicers (bottom) at August 2009 foreclosure prevention event.

Credit: Federal Reserve Bank of Richmond

Homeowner Outcomes

To obtain firsthand information from homeowners seeking mortgage assistance, we followed for at least a year a sample of homeowners who had attended foreclosure prevention events in either 2009 or 2010 (see sidebar for a description of the study's data and methodology). At the events, the homeowners could initiate a renegotiation with their servicer; find out the status of their mortgage renegotiation that was underway; or pick up information about foreclosure and how to prevent it.

Consistent with the national data described earlier, the majority of homeowners in our study had experienced a combination of negative equity and adverse shocks. Around 88 percent of homeowners in our sample had experienced some kind of an adverse shock and nearly three-fourths had negative equity in their houses.

"I paid off my mortgage for three years without a problem until I was laid off in January 2009, and since my spouse had medical problems and needs assistance from time to time; I fall behind unexpectedly."

– April 2010 Event Attendee

Approximately, two-thirds of homeowners in our sample received mortgage assistance in the form of loan modification or refinancing. We were interested in finding out if this assistance had a positive effect on the homeowners' mortgage outcomes. We found that homeowners who received assistance were subsequently significantly more likely to be current on their mortgage payments compared to homeowners who did not receive assistance. However, we cannot attribute the homeowners' success in becoming current to the receipt of assistance alone. We observed that servicers were more likely to offer assistance to those who were employed, for example. In other words, servicers may have selected to offer assistance to homeowners who were more likely to succeed with it.[19]

"I realize that the mortgage company had a desire to be paid and we had a desire to receive assistance because we were unable to pay. The process has been long and very overwhelming. I believe employment was the defining point for the mortgage company's ability to work with me and my family."

– August 2009 Event Attendee

Note, however, that assistance did not guarantee success; roughly 59 percent of the homeowners who received assistance failed to become current on their mortgage payments. These homeowners often had significant negative equity or had faced large adverse shocks such as illness or job loss by the household's sole income earner.

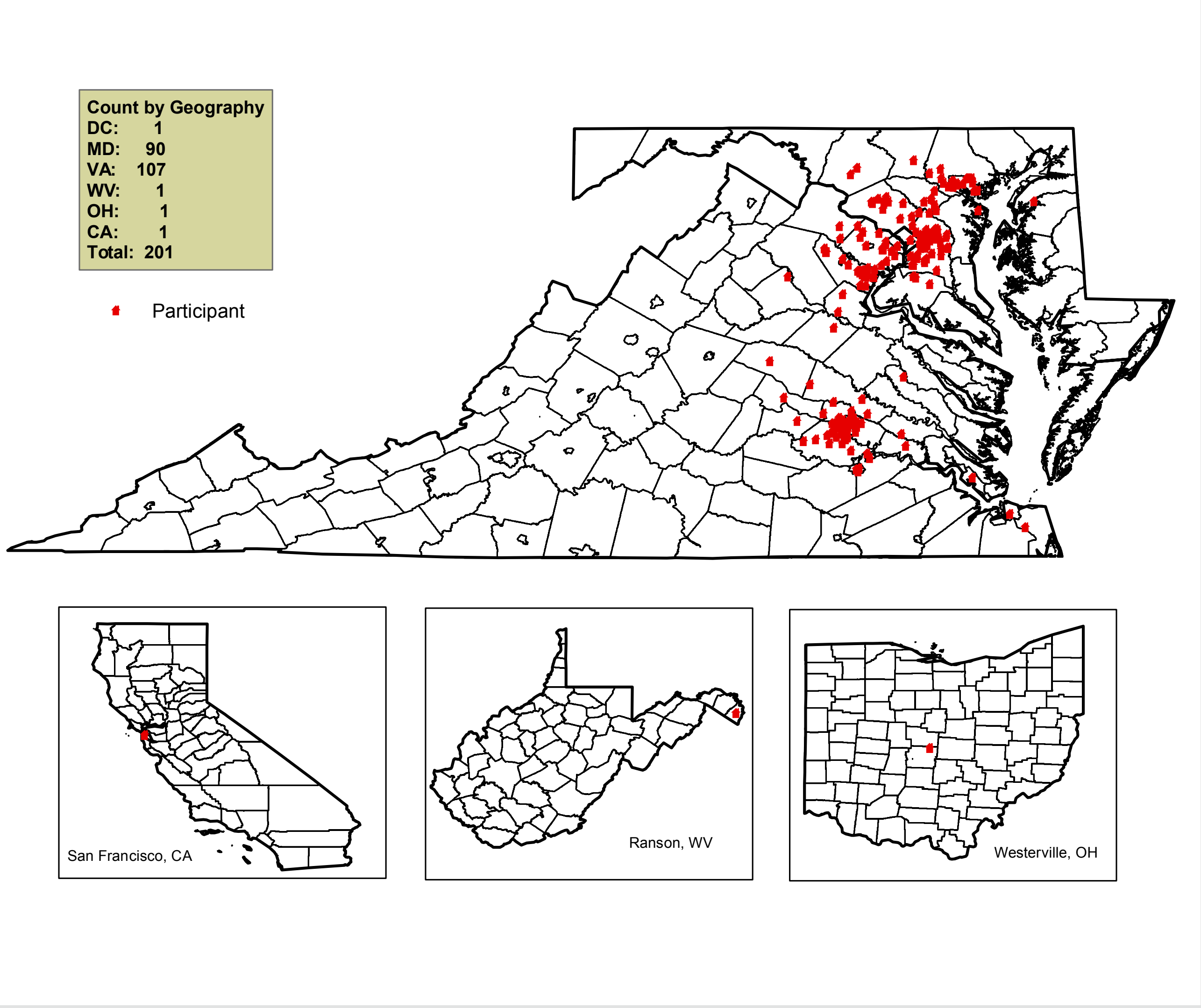
"When I received the modification my payment only went down by $100.00. I'm trying to find out what type of programs are out there to help me with refinancing because I am so upside down."

– April 2010 Event Attendee

Description of Study's Data and Methodology

In 2009 and 2010, we asked attendees at foreclosure prevention events in Maryland and Virginia to voluntarily complete a short survey onsite. Homeowners from at least five states and the District of Columbia attended the events as shown in the map below. The majority of our survey respondents were from the Virginia and Maryland suburbs of Washington, D.C.

Location of the Sample of Foreclosure Prevention Event Attendees with Known Addresses



From March 2010 to December 2011, we conducted three rounds of follow-up surveys with the 203 attendees who completed our onsite survey. In all, 121 homeowners completed at least one follow-up survey. We used their responses along with other data sources to develop a unique dataset with information on the homeowners' demographic and socioeconomic backgrounds, loan characteristics, property characteristics, assistance received and foreclosure notifications.

To determine what factors played a role in enabling homeowners to avoid foreclosure, we estimate a series of logistic regression models on a sample of 77 homeowners.[20] In particular, we were interested in whether and to what degree receipt of assistance, equity in the home, household income, and adverse shocks incidence influence the likelihood of avoiding foreclosure.

Conclusion

A mortgage modification does not necessarily resolve the adverse life events that triggered the mortgage difficulties in the first place. While homeowners who received assistance were more likely to end up current on their mortgage payments, we observed many cases in which the receipt of assistance failed to negate the effects of adverse shocks such as employment loss, a serious illness or the death of a household member. This suggests that homeowners may be better off when solutions are targeted to their underlying problem rather than just the mortgage. Potential solutions might be found in financial buffers or insurance that provide financial support during a time of such shocks.

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