Statement

Of

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Domestic Policy Subcommittee
Oversight and Government Reform Committee
Friday, November 14, 2008

10:00 a.m.

"Is Treasury Using Bailout Funds to Increase

Prevention as Congress Intended?"

Thank you Chairman Kucinich and Ranking Member Issa for the opportunity to address the Members of the Subcommittee.

My name is Larry B. Litton, Jr. I am the Chief Executive Officer of Litton Loan Servicing, which manages a portfolio of 450,000 mortgage loans totaling $75BB of predominantly subprime mortgages.

I was asked to provide insight into how loan modifications are performing in today's environment and ways servicers can help homeowners stay in their homes during these difficult times. I hope my statements provide the committee with a better understanding of what's happening on the front lines as we work toward reducing mortgage defaults and preserving homeownership whenever possible.

Role of Servicers.

Servicers are a key participant in efforts to help individual homeowners as the intermediary between investors in mortgage loans and the homeowners. The servicer performs a number of administrative tasks, such as collecting monthly payments, escrowing and paying property taxes and homeowners insurance, and sending out year-end tax information to the borrower and to the IRS. In addition, the servicer forwards borrower payments to the lender who made the original loan or to the investors who bought the loan from the originator. Servicers also have a contractual duty to maximize the recovery of principal and interest for investors.

In these trying economic times, a servicer's focus should shift primarily to determining how to cure defaulting mortgages and to how to modify these loans to make them perform again. Modifications are a component of what our industry calls loss mitigation, and we believe modifications are the best way to prevent or cure defaults and help customers continue to pay their mortgages and stay in their homes.

Litton has been a strong and consistent proponent of responsible loan modifications since my father founded the company in 1988. As a servicer, we believe that our contractual obligation to maximize the recovery of principal and interest for the investors whose loans we service is compatible with offering a host of options that afford struggling homeowners a second chance to keep their homes. We make this part of our everyday business practices.

Observations on Today's Environment.

In the past year, we have observed four notable trends that are presenting increased challenges to servicers, and more importantly, homeowners:

- An increase in default rates
- An increase in re-default rates
- A decrease in customers accepting loan modifications

- An increase in the foreclosures of vacant properties

As this crisis has unfolded, default rates increased to more than 40% today, up from 35% over the past 12 months. Also, we have seen a slow but steady rise in re-default rates associated with modifications accepted by homeowners. Twelve months ago our re-default rate averaged about 30%. Today the rate is in excess of 40%.

We also have observed an incremental decrease in the frequency of homeowners accepting loan modifications. Twelve months ago, more than 40% of our customers accepted pre-approved modifications. Today this number is around 20%.

In regard to vacant properties, today we know that at least 25% of the loans we service that go into foreclosure are vacant, which is a 100% increase over where we were 12 months ago. Many times these homeowners did not respond to loan modification offers and have simply walked away from their homes.

It is clear that our customers are facing tremendous economic head winds driven by higher instances of job loss, wage compression, high debt loads, and other issues. It is also clear that the mortgage servicing industry needs to continue to do more and adjust to these conditions. With house values, loan performance, and the overall economy on the decline, this is the time we need to be more aggressive with the terms of our loan modifications and find ways to get homeowners' payments down further. We believe this is good for both homeowners and investors.

Litton's Response on Loan Modifications.

Over the past 12 months, we are proud to report that we have modified more than 41,000 loans. This represents 12% of our portfolio and 38% of loans that were 60 days or more past due. When we modify loans, we consider the following approaches: writing down principal, waiving all or part of arrearage, decreasing interest rate and/or extending the loan term. Despite the work we have done to modify these loans, we have not seen an appreciable decline in new foreclosure starts over this same period. In fact, delinquency rates as well as foreclosure rates are up not just in our portfolio but nationally as well.

Historically, Litton's average modification involved a payment reduction of $200 per month, which resulted in an average housing debt-to-income ratio of 39%.

In response to the current environment, we recently implemented a modification debt-to-income standard of 31%, which is consistent with FHA guidelines for new loans. Our expectation is that after a period of making payments on the loan modification many of our customers will be able to refinance into a fixed rate FHA loan. Our belief is that using this standard will allow us to do more loan modifications with greater payment relief to the homeowner, thus providing a more sustainable solution. Our investors will still benefit, as we are confident we can demonstrate a significant savings over the foreclosure outcome.

Investor and Homeowner Outreach.

Investor education is an important part of our efforts. As I mentioned, we are confident in our ability to demonstrate to our investors that loan modifications generally produce a significantly lower total loss than foreclosures. Before we complete a modification, we project the loss that would be realized should we foreclose and compare that value to the value of cash flow generated via a modified loan. When we can demonstrate that the loss would be lower in the modification example, we proceed with the modification.

Homeowner education and outreach is another essential component to achieving more loan modifications. We have found that working with local housing and consumer agencies has been an important part of our ability to reach homeowners who are otherwise unwilling or afraid to respond to our outreach efforts.

We have a relationship with a particular housing counseling agency that we think illustrates an effective model for the servicer-counseling agency relationship. The East Side Organizing Project of Cleveland, Ohio, known as ESOP, has assisted us in reaching homeowners throughout Ohio, and thus far, to complete modifications for more than half of the customers they have referred to us; a very high success rate. Further, many other customers referred to us by ESOP have received other types of workouts that were more appropriate for their situation. We believe ESOP's success stems from its commitment to providing homeowners with quality and realistic counseling and by encouraging them to actively participate in the modification process.

Recommendations.

It is clear that the negative trends related to new mortgage defaults, re-defaults on modified loans, customers accepting modifications, vacant properties, foreclosure starts, and declining home prices all present significant challenges. We urge the servicing industry and policy makers to work together to continue to develop partnerships between the public, private, and non-profit sectors to inform homeowners of their options and the often little understood consequences of walking away from their homes. It is certainly in everyone's interests to keep homeowners in their homes whenever possible.

Finally, as and industry, servicers should look to do all they can to create responsible, affordable loan modifications that are possible within the guidelines of their contractual obligations to investors and use all available resources to connect with homeowners during this important time. Servicers need to use more reasonable debt-to-income standards when creating modifications to provide more payment relief for homeowners. Although modifications to existing mortgage terms certainly are not a panacea that will cure all that ails the current housing market, we believe that thoughtful restructuring of existing arrangements to provide homeowners with payment relief is a positive step toward combating its decline.

Thank you again for allowing me to share Litton's views, and I would be happy to answer any questions you may have.