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Recently Announced Revisions to the Home Affordable Mortgage Program (HAMP)

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Chairwoman Waters, Ranking Member Capito and members of the Committee, thank you for this opportunity to testify concerning the vital questions of how we are responding and should respond to the foreclosure crisis. I have studied the subprime mortgage industry for the past ten years, and I am conducting ongoing research on mortgage defaults, foreclosures, workouts and modification agreements. I testified in September 2008 before the House Financial Services Committee about the inadequacy of voluntary action by mortgage servicers, and unfortunately the foreclosure crisis has grown dramatically worse since then. Month after month, up to and including March 2010, foreclosures and defaults remain at or near crisis peak levels. Voluntary mortgage modifications have failed to keep pace with foreclosures, much less turned the tide.

Amid the signs of gradual economic recovery, it is easy to lose sight of two critical facts. First, foreclosures and mortgage defaults remain at unprecedented levels not seen since the Great Depression.[1] Second, while the bubble in home prices has burst and they have declined by as much as 30%, the mortgage debt hanging over American homeowners has stubbornly refused to come down. Having doubled from $5 trillion to $10.5 trillion in seven years, home mortgage debt has eased by only about 3 percentage points in the past three years, and remains above $10 trillion.[2]

After twelve months, the Administration's Home Affordable program can only be judged a failure. In its current form, HAMP will not and cannot achieve the necessary degree of foreclosure prevention and mortgage debt reduction that are the essential prerequisites to an economic recovery. The goal of helping 3 to 4 million homeowners was ambitious but necessary to have an impact on the crisis. Through February there have been fewer than 200,000 permanent modifications, a number that cannot realistically be expected to mitigate the crisis.

In fact, the net impact of HAMP has been to sharply *reduce* permanent modifications from April 2009 through February 2010, by redirecting servicer efforts. This was partly a result of the unnecessarily prescriptive documentation requirements and the 3-month trial modification feature imposed by Treasury. Before HAMP was announced in March 2009 servicers were voluntarily and permanently modifying about

[1] Mortgage Bankers Association of America, National Delinquency Survey Fourth Quarter 2009 (reporting that 4.58% of all mortgages are in foreclosure and 10.44% are delinquent, compared with roughly 1% and 4%, respectively, in 2005).

[2] Federal Reserve Board of Governors, Statistical Release Z.1, table D.3 March 11, 2010.

120,000 mortgages each month. After HAMP went into effect, that number dropped to about 80,000 monthly.[3] It appears that as of March 2010 permanent modifications are just getting back to their pre-HAMP levels.[4] There is still no overall increase in modifications, or reduction in foreclosures, resulting from HAMP. New foreclosure starts were running at about 200,000 monthly at the end of 2009.

The recently announced changes to HAMP are not likely to increase the program's success significantly. The short-term payment relief for unemployed borrowers is commendable but limited to six months it is unlikely to help a sizeable number of the unemployed. Most servicers are already able to offer short-term forbearance plans of three to six months for unemployed borrowers without HAMP subsidies. Treasury and Congress should consider longer-term assistance for the unemployed, such as the 18-month assistance program offered by the Pennsylvania Housing Finance Agency (HEMAP). The new option to consider principal reduction, given that it is entirely voluntary, seems to me highly unlikely to affect servicer behavior.

Servicers continue to provide half to two-thirds of their permanent modifications outside the HAMP program. This is very troubling, given that servicers are giving up substantial subsidies and income from Treasury in order to avoid having to comply with HAMP rules and guidelines. The reasons for this are not clear, but suggest a need for Treasury to look closely at the proprietary modifications being done by servicers, including their payment performance, in order to improve the HAMP guidelines.

Separate from the question of preventing the tragedy of unnecessary foreclosure is the policy imperative of addressing the $10.2 trillion mortgage debt overhang. HAMP has not in any way helped with overall mortgage debt reduction, or what I call deleveraging the American homeowner. If anything, its "extend and pretend" approach is increasing household debt. Rather than urging servicers to consider principal reduction as an optional tool it should be made mandatory, and the HAMP subsidies should be targeted at principal reduction and interest write-offs. Not only is mortgage debt reduction essential for macroeconomic reasons, but also modifications with principal reduction have consistently been shown to re-default at significantly lower rates.[5] The Special Inspector General For The Troubled Asset Relief Program (SIGTARP) reports

[3] These numbers are from the HOPE NOW coalition data reports, available at https://www.hopenow.com/industry-data.php. See table 3.

[4] See Tables 1 and 3 appended to this testimony, summarizing modification totals from the Columbia collateral data file of securitized mortgages, as well as the HOPE NOW and OCC/OTS mortgage metrics data. HOPE NOW reports that total HAMP and non-HAMP modifications now exceed pre-HAMP levels, but that has not yet been confirmed in the OCC/OTS or Columbia data.

[5] OCC/OTS Mortgage Metrics report for 2009 Fourth Quarter, available at http://www.ots.treas.gov/?p=Mortgage%20Metrics%20Report; UNC Center for Community Capital, Tailoring Loan Modifications: When Is Principal Reducation Desirable?, August 23, 2009.

that the average mortgage debt for borrowers in HAMP trial modifications is between 115% and 140% of their home value.[6]

Mandatory principal reduction can only be achieved through a combination of bankruptcy reform, a comprehensive plan to buy the banks' delinquent and at-risk underwater second mortgages at fair value and incorporating mandatory principal reduction for underwater borrowers into the HAMP program. If this is not successful a mortgage purchase program similar to the HOLC may be needed. In March 2010 about 20% of foreclosure liquidations were second mortgages. The average loss severity was in excess of 100% of the original balance, i.e. the recovery was insufficient to pay even interest and fees, let alone any principal debt. About 30% of securitized subprime and alt-A second mortgages are delinquent.[7] These at-risk second mortgages, and more importantly the at-risk second mortgages on the balance sheets of banks, need to be resolved in a prompt but orderly fashion.

Taxpayer subsidies for necessary mortgage write-downs should be kept to a reasonable minimum. First lien foreclosures are resulting in losses in excess of 50%, and second liens foreclosure losses exceed 100%. In the case of second liens, taxpayers should not overcompensate banks and investors for mortgages of little or no economic value.

The new FHA write-down and refinance program will not work. Like the failed Hope for Homeowners program, it requires lenders or servicers to voluntarily reduce the principal on both first mortgages and second mortgages. Treasury will now offer to pay 10% to 21% of the second mortgage balance written down in the context of an FHA refinance. Under the previous second mortgage program (2MP, which apparently was never fully implemented) Treasury offered to pay either an incentive to servicers and investors that modified second mortgages to make payments affordable, or a subsidy of 6% to write down delinquent second mortgages and 10% to 20% to write down current second mortgages. Treasury now believes that second mortgage holders will be more likely to accept 10 to 20 cents on the dollar to cancel their loans in the context of a refinancing of the first mortgage than in connection with a first mortgage modification. But the effect on the second mortgage investor is the same – they are asked to write off 80% to 94% of the debt. No bank or investor has shown much willingness to accept that level of loss to date.

What further steps are needed to achieve real reductions in foreclosures and mortgage debt? First, Congress should enable bankruptcy courts to write down mortgage balances to home values for distressed homeowners. Chairman Frank warned the industry in 2008 that this would happen if the voluntary foreclosure mitigation programs failed. They have failed.

Second, the junior mortgage lien problem should be addressed promptly and systematically, with mandatory, not voluntary, purchases of at-risk underwater junior

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[6] Special Inspector General for the Troubled Asset Relief Program, Factors Affecting Implementation of the Home Affordable Modification Program, March 25, 2010.

[7] These data are from the Columbia Collateral file.

liens at no more than 10% of outstanding balances. Estimates are that one-third to one-half of distressed first mortgages are associated with a second mortgage, amounting to perhaps one to two million borrowers. Thus if the average at-risk second mortgage amount is roughly $50,000, a 10% subsidy or purchase price would amount to $5,000 per mortgage, or $5 to $10 billion to eliminate $50 to $100 billion in distressed second lien debt. Appropriate Congressional legislation could authorize Treasury to compel lenders to sell their at-risk second mortgages to Treasury for a nominal amount in any case where the first or second mortgage is seriously delinquent and the first mortgage exceeds the home value. It should be noted that the majority of second mortgages, whether underwater or not, are not associated with a defaulted first mortgage and would not be affected.

Third, mortgage servicer performance must be addressed. In many cases, evidenced in consumer lawsuits and complaints, servicers are proceeding with foreclosures and sales while modification requests are pending, or even after they are approved.[8] Modification requests are languishing for as long as a year, servicers repeatedly ask borrowers to resubmit documentation that has been lost or become outdated, and housing counselors and mediators are unable to get timely information and responses from servicers. The HAMP call center reports receiving 39,625 borrower complaints about servicer compliance, including 5,170 calls reporting that the servicer lost the borrower's paperwork, 4,303 reports that the servicer incorrectly told the borrower they must stop making payments to qualify for a modification, and 1,457 complaints of servicers charging fees for HAMP applications or modifications.[9] I understand that Chairwoman Waters has personally experienced servicer failures while working on behalf of constituents.

Treasury should take action against servicers whose HAMP performance is inadequate. The monthly HAMP reports reveal that some servicers are much more successful than others at getting delinquent homeowners into temporary modifications and at converting temporary modifications to permanent ones. Congress should consider mortgage servicing legislation to provide better consumer protection and perhaps to allow consumers (or Treasury in cases where the taxpayer is the ultimate investor) to fire servicers. Another option would be compulsory transfer of servicing rights to servicers with high performance ratings.

You have also asked for my views on prevention of future foreclosure crises. Thus far the only legal restriction on a new wave of subprime and alt-A high-risk

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[8] E.g. Complaint in Reyes v. IndyMac Mortgage Services, Inc. Civil Action 10-10389, Federal District Court District o Massachusetts (March 4, 2010); Sandra Forester, Owner Says their Boise Home was Sold Without Their Knowledge, Idaho Statesman April 7, 2010; Arthur Delaney, Chase Sued: Allegedly Told Homeowner to Stop Payments, then Foreclosed, Huffington Post, April 6, 2010.

[9] MHA Call Center Overview, February 2010, available at: http://www.financialstability.gov/docs/Borrower%20Contact%20Report%2003%2012%2010_FINALDRAFT3.pdf.

mortgages is the Federal Reserve's HOEPA regulation issued in 2008.[10] The Fed rule laudably bans no-doc mortgages, but only for mortgages priced at subprime rates, i.e. 3% above prime interest rates. It also restricts prepayment penalties for subprime mortgages, although some are still permitted. The risky mortgage features that have been clearly identified with the foreclosure crisis include undocumented income, 100% financing (i.e. no down payment mortgages), non-amortizing and negatively amortizing mortgages (i.e. monthly payments of interest only or less-than-interest-only), and prepayment penalties. These high-risk product features, alone or in combination, should be restricted, possibly in the way that investors are restricted from high-risk investment strategies, i.e. only very sophisticated individuals should have access to them. The Fed rule falls short in two fundamental ways: first it does not address the alt-A sector, i.e. mortgages with low interest rates but risky features, and second it does not address two of the four important risk features even for subprime mortgages, namely borrower equity and amortization. There is no significant subprime and alt-A mortgage lending in the market today, because of lender and investor skepticism about controlling the risk of these mortgage products. Over time, the investor fear and doubt will fade, and another cycle of reckless lending could develop, in the absence of sensible regulation. At this point the preferred approach in Congress seems to be to continue delegating these important decisions to administrative agencies, including perhaps a new consumer protection agency. Until clear limits on risky mortgage terms are put in place, Ponzi finance may yet return to the mortgage market.

In the long run, sustainable homeownership for low- and moderate-income families should be supported by a narrowly tailored federal intervention in the mortgage market. F.H.A. should be restored to the role it played before it was displaced by subprime mortgages, namely to provide access to low-income homebuyers who cannot otherwise qualify for financing. This requires finding an appropriate balance between reducing access barriers on the one hand, while avoiding zero down financing and unsustainable mortgage structures on the other hand. Fannie Mae, Freddie Mac and the Federal Home Loan Banks should provide capital for the low-priced end of the housing market, buying only safe and sustainable mortgage products, while private capital markets should finance he middle and upper end of the housing market. For all their flaws, at this juncture F.H.A., Fannie and Freddie are filling a vital role as a backstop to the collapsed private mortgage market.

Detailed summaries of the mortgage foreclosure and modification data I am following are available on my web page at:
http://www.valpo.edu/law/faculty/awhite/data/index.php

In addition I have written two papers summarizing the limitations of voluntary mortgage modifications in 2007 and 2008, which are available at:
http://ssrn.com/abstract=1325534 and http://ssrn.com/abstract=1259538.

I would be happy to answer any questions, and to respond to any specific queries from you or your staff regarding the available foreclosure and modification data.

[10] Federal Reserve Board, Truth in Lending Final Rule, 73 Federal Register 44521 (July 30 2008).

Table 1: Foreclosures and modifications, Columbia Collateral Files

Columbia Collateral File, 2000 to 2007 pools inclusive							
Report month	Total Loans	Bankruptcy	Foreclosure	REO	Foreclosures + BK + REO	FC +BK + REO as % of loans	Modifications
11/08	3,530,589	68,697	233,114	141,489	443,300	12.56%	21,221
12/08	3,462,975	67,878	235,965	139,913	443,756	12.81%	20,392
1/09	3,417,382	67,311	241,990	138,999	448,300	13.12%	23,224
2/09	3,385,216	68,388	248,723	140,853	457,964	13.53%	23,749
3/09	3,313,489	67,000	256,468	137,307	460,775	13.91%	20,894
4/09	3,295,897	67,611	271,769	126,931	466,311	14.15%	21,404
5/09	3,206,178	68,778	277,847	118,358	464,983	14.50%	19,041
6/09	3,173,292	70,324	281,560	111,662	463,546	14.61%	18,179
7/09	3,105,754	71,409	282,912	106,848	461,169	14.85%	14,149
8/09	3,029,722	72,663	282,148	101,777	456,588	15.07%	13,269
9/09	2,949,127	72,912	279,426	96,269	448,607	15.21%	12,132
10/09	2,893,727	71,163	279,353	91,619	442,135	15.28%	12,704
11/09	2,857,413	72,843	276,591	91,088	440,522	15.42%	12,908
12/09	2,795,333	71,617	275,560	87,685	434,862	15.56%	14,309
1/10	2,764,568	70,726	273,559	85,179	429,464	15.53%	15,642
2/10	2,718,236	69,846	268,569	87,204	425,619	15.66%	14,592
3/10	2,680,982	69,777	262,338	86,264	418,379	15.61%	21,821

N.B. The Columbia Collateral file is made available to investors each month, and provides performance data on securitized subprime and alt-A mortgages. It covers about 5% of the mortgage market and about 20% of mortgages in default or foreclosure. Only permanent modifications are reported, and no distinction is made between HAMP modifications and other modifications.

Table 2: Types of modifications, Columbia Collateral File

Columbia Collateral File, 2000 to 2007 pools inclusive						
	Mod P&I Positive Change *	Mod P&I Negative Change*	Mod P&I No Change*	%Mods w/ PmtReduced*	Number with write-offs	Percent with write-offs
11/08	8,528	9,802	2,891	46.2%	2,808	13.23%
12/08	7,627	9,850	2,915	48.3%	2,375	11.65%
1/09	8,789	11,365	3,070	48.9%	2,808	12.09%
2/09	7,275	11,162	3,674	50.5%	3,993	18.06%
3/09	5,984	10,628	2,816	54.7%	3,958	20.37%
4/09	5,827	11,760	2,363	58.9%	3,233	16.21%
5/09	5,138	10,575	2,296	58.7%	2,343	13.01%
6/09	4,819	9,949	2,289	58.3%	3,135	18.38%
7/09	3,197	8,523	1,498	64.5%	1,140	8.62%
8/09	3,003	7,848	1,478	63.7%	528	4.28%
9/09	2,597	7,350	1,273	65.5%	615	5.48%
10/09	2,571	7,535	1,583	64.5%	753	6.44%
11/09	2,499	7,955	1,305	67.7%	982	8.35%
12/09	2,257	9,555	919	75.1%	1,226	9.63%
1/10	2,385	10,850	1,020	76.1%	1,191	8.35%
2/10	1,978	11,677	937	80.0%	1,208	8.28%
3/10	2,462	16,183	1,245	81.4%	1,483	7.46%

Table 3 – Permanent mortgage modifications reported by HOPE NOW, OCC/OTS and Columbia Collateral file

	Modifications in Columbia file	HOPE Now Modifications	OCC/OTS Mortgage Metrics Modifications
11/08	21,221	98,000	40,000
12/08	20,392	122,000	41,000
1/09	23,224	117,000	63,000
2/09	23,749	127,000	63,000
3/09	20,894	127,000	63,000
4/09	21,404	118,000	47,000
5/09	19,041	99,000	47,000
6/09	18,179	94,000	47,000
7/09	14,149	80,000	44,000
8/09	13,269	86,000	44,000
9/09	12,132	75,000	44,000
10/09	12,704	73,000	41,000
11/09	12,908	82,000	41,000
12/09	14,309	139,000	41,000
1/10	15,642	149,000	-
2/10	14,592	148,000	-
3/10	21,821		