

July 6, 2009

---

## Introduction

Several months into the Home Affordable Modification Program (“HAMP”), advocates for homeowners report that the program is not providing a sufficient number of loan modifications to homeowners,<sup>1</sup> the modifications offered often do not meet the guidelines of the program, and the program itself still presents serious barriers to mass loan modifications. While the introduction of the program is the best effort yet to stem the tide of foreclosures, substantial additional steps are needed.

### **Certain Key HAMP Policies Must Be Changed to Provide Sustainable Modifications and Save Communities**

*The NPV model for qualifying homeowners must be available to the public.*

A homeowner’s qualification for a loan modification under HAMP is determined primarily through an analysis of the Net Present Value (“NPV”) of a loan modification as compared to a foreclosure. The test measures whether the investor profits more from a loan modification or a foreclosure. Most investors require that servicers perform some variant of this test prior to foreclosure.<sup>2</sup> The outcome of this analysis depends on inputs including the homeowner’s income, FICO score, current default status, debt-to-income ratio, and property valuation, plus factors relating to future value of the property and likely price at resale. Participating servicers are required to apply this analysis to all homeowners who are 60 days delinquent and those at imminent risk of default. Homeowners and their advocates need access to the program to determine whether servicers have actually and accurately used the program in evaluating the homeowner’s qualifications for a HAMP modification. Without access to the NPV analysis, homeowners are entirely reliant on the servicer’s good faith.

*All foreclosure proceedings must be stopped, not just at the point before sale.*

While many servicers are placing homeowners in foreclosure and proceeding to sale in violation of HAMP guidelines (as described below), even compliance with the current rule is pushing homeowners into costlier loan modifications and tilting the scales toward foreclosure. In judicial foreclosure states, servicers are aggressively pursuing foreclosures while reviewing homeowners for loan modifications. As a result, homeowners are incurring

---

\* This analysis was produced by Alys Cohen, Staff Attorney, & Diane Thompson, Of Counsel.

<sup>1</sup> See, e.g., California Reinvestment Coalition, *The Ongoing Chasm Between Words and Deeds: Abusive Practices Continue to Harm Families and Communities in California* (2009); Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 29, 2009.

<sup>2</sup> American Securitization Forum, *Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans* (June 2007), available at [http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles\\_060107.pdf](http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf).

thousands of dollars in costs. Servicers either demand these payments upfront (an apparent violation of HAMP) or capitalize the costs without permitting any review by the homeowner. In either event, these costs make it harder to provide an affordable loan modification and the continuation of the foreclosure causes homeowners great stress. All foreclosure proceedings should be stayed while HAMP reviews occur.

*Homeowners need principal reductions, not forbearance.*

Principal forgiveness is necessary to make loan modifications affordable for some homeowners. Existing data on loan modifications show that loan modifications with principal reductions tend to perform better. The need for principal reductions is especially acute – and justified – for those whose loans were not adequately underwritten and either 1) received Payment Option Adjustable Rate Mortgage (“ARM”) loans that negatively amortize until as much as 125% of the original balance is owed; or 2) obtained loans that were based on inflated appraisals. Homeowners are more likely to default when they owe more on their homes than they are worth,<sup>3</sup> regardless of their payment level. The HAMP program recognizes this; the HAMP NPV model increases the probability of default the further underwater the homeowner is, even if payments are low and affordable. Yet HAMP does not address this problem, unlike the Federal Reserve Board’s loan modification program, which mandated principal reductions when the outstanding loan balance exceeded 125% of the home’s current market value. While forbearance provides affordable payments, it prevents a homeowner from selling or refinancing to meet a needed expense, such as roof repair or college tuition, and sets both the homeowner and the loan modification up for future failure.

*Homeowners suffering an involuntary drop in income should be eligible for a second loan modification review.*

Even after a loan modification is done successfully and is performing, homeowners may still become disabled, lose their jobs, or suffer the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors money and preserve homeownership. Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further HAMP modification is punitive to homeowners already suffering a loss and does not serve the interests of investors. Some servicers provide some modifications upon re-default as part of their loss mitigation program; this approach should be standard and mandated, and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

*Homeowners in bankruptcy should be provided clear access to the HAMP program.*

As a result of the HAMP guidelines providing servicer discretion on whether to provide homeowners in bankruptcy access to loan modifications under the program, homeowners generally are being denied such loan modifications. The HAMP guidelines should provide clear guidance on instances where a loan modification should be provided to homeowners in

---

<sup>3</sup> Andrey Pavlov & Susan Wachter, *Aggressive Lending and Real Estate Markets* (Dec. 20, 2006), available at <http://realestate.wharton.upenn.edu/newsletter/pdf/feb07.pdf>.

bankruptcy. The HAMP guidelines should explicitly provide that servicers must consider a homeowner seeking a modification for HAMP even if the homeowner is a debtor in a pending bankruptcy proceeding.

Servicers should be required, upon receipt of notice of a bankruptcy filing, to send information to the homeowner's counsel indicating that a loan modification under HAMP may be available. Upon request by the homeowner and working through homeowner's counsel, servicers should offer appropriate loan modifications in accordance with the HAMP guidelines prior to discharge or dismissal, or at any time during the pendency of a chapter 13 bankruptcy, without requiring relief from the automatic stay and in the case of a chapter 7 bankruptcy, without requiring reaffirmation of the debt. The bankruptcy trustee should be copied on all such communications. All loan modifications offered in pending chapter 13 cases should be approved by the Bankruptcy Court prior to final execution, unless the Court determines that such approval is not needed. If the homeowner is not represented by counsel, information relating to the availability of a loan modification under HAMP should be provided to the homeowner with a copy to the bankruptcy trustee. The communication should not imply that it is in any way an attempt to collect a debt. Finally, as discussed below, the trial modification payment rules should take into account the fact that payments may be passed through the bankruptcy trustee, rather than directly from homeowner to servicer.

*Mortgages should remain assumable as between spouses, children, and other persons with a homestead interest in the property.*

Federal law, the Garn-St. Germain Depository Act of 1982, specifically forbids acceleration when the property is transferred from one spouse to another and permits a spouse or child to assume the mortgage obligations.<sup>4</sup> Freddie Mac has long allowed mortgage assumptions by relatives as one method of working out delinquent mortgages. Such transfers are most likely to occur upon death or divorce, which may happen in the context of domestic violence. Following these policies, the HAMP program should allow mortgages for certain homeowners to be assumable. Homeowners who have recently suffered the death of a loved one should not find themselves immediately faced with foreclosure or suddenly elevated mortgage payments.

*Transparency and fair lending principles must be ensured throughout the HAMP process.*

Incentive payments for pre-default homeowners are aimed at the necessary policy of ensuring that homeowners already facing hardship obtain sustainable loans, yet the additional funds for such reviews may implicate fair lending issues. The home price decline protection program may result in payments focused more on non-minority areas and should be reviewed for fair lending concerns. Servicer incentive payments based on reductions in the dollar amount of a payment also may raise fair lending considerations. Moreover, hardship affidavits and paperwork must be made available in appropriate languages to ensure wide access to the program. Data on loan modifications and applications are essential to

---

<sup>4</sup> 12 U.S.C. § 1701j-3(d)(6) (2008) (transfer from borrower to spouse or children); 12 U.S.C. § 1701j-3(d)(7) (2008) (transfer to spouse pursuant to divorce decree or legal separation agreement).

ensuring equitable access to the program; these data must all be available as of Fall 2009. Any further delay will limit transparency and delay accountability.

*HAMP application procedures should better recognize & lessen the impact of exigent circumstances.*

Aspects of the loan modification procedures, or gaps in current guidance, create hurdles for certain homeowners. For example, victims of domestic violence are unlikely to be able to obtain and should not be required to obtain their abuser's signature on loan modification documents. While predatory lending and predatory servicing can create default and an imminent risk of default, as recognized by the HAMP plan, the hardship affidavit does not contain an explicit reference to either category. Thus, at present, a loan modification would be available only to a homeowner who realizes that the fraud and predatory behavior that resulted in unreasonable levels of debt are legitimate grounds for seeking a modification and who is able to articulate and defend that categorization to a line-level employee of the servicer who may be relying in a formulaic way on the categories contained in the hardship affidavit or may be outright hostile to claims of predatory behavior. The application process also should explicitly prohibit reaffirmation of mortgage debts in future bankruptcies (in light of the waivers described below), instead of requiring such reaffirmation, as it now does.

*The trial modification program should be further formalized and clarified.*

The trial modification program currently complicates matters for participating homeowners by increasing costs and failing to maximize the chances for long-term success. Payments received during the trial modification period should be applied to principal and interest, not held in suspense until the end of the trial period. Trial modification payments should be applied as if the modification, and any capitalization, occurred at the outset of the trial period, with payments allocated accordingly between principal and interest. The policy of capitalizing arrears at the end of the modification period, including any difference between scheduled and modified payments, penalizes homeowners (including those not in default at the time of the trial modification) by raising the cost of the modification and increasing the chances that some homeowners will not pass the NPV test. The use of suspense accounts and capitalizing arrears after the trial period render meaningless the term "modification" in "trial modification." In addition, homeowners who are not delinquent at the start of the trial period and who are making payments as agreed under the trial plan currently are reported to credit bureaus as making payments under a payment plan; they should not face decreased credit scores simply because they are seeking to attain a responsible debt load. For homeowners in bankruptcy, the new rules defining when trial payments are "current" fail to take into account the delay in initial disbursement that may occur when payments are made through the chapter 13 trustee. Finally, homeowners need some assurance at the time of the trial modification that, if their income is as represented upon approval of the trial modification, the servicer will provide a final modification on substantially similar terms. Homeowners are bound by the trial modification; it is not clear that servicers are.

*The second lien program should be further developed to promote coordination with first lien modifications.*

The second lien program should work in concert with the primary lien modification program to the greatest extent possible. Only such coordination will result in maximizing the potential of the program to save homes and communities.

### **Participating Servicers Violate Existing HAMP Guidelines**

*Waivers of claims and defenses are still being required by servicers.*

The HAMP program rollout language prohibits waivers of legal rights. Many servicers still are seeking waivers from homeowners or an admission of default. Servicers also have asked homeowners to waive their right to a HAMP loan modification review in favor of a non-HAMP loan modification. Not only does this violate HAMP rules but it demonstrates bad faith. Some servicers also are requiring homeowners to sign a waiver that states that any HAMP loan modification will be suspended if the homeowner subsequently files for bankruptcy (which will be likely for some set of homeowners in part because re-defaults do not entitle homeowners to a second modification).

*Foreclosures are proceeding during the HAMP review process in violation of HAMP guidelines.*

Servicers often negotiate loan modifications on a separate track from the personnel pursuing foreclosure. This structure is resulting in homeowners being placed in foreclosure, and being subject to a foreclosure sale, while HAMP review is occurring.

*Lack of transparency is resulting in summary denials and other unreasonable acts by servicers.*

Servicers often spend many weeks processing a loan modification offer and then require a homeowner to return the paperwork after only a few days of review. The offer often includes assumptions about arrears that are undocumented and apparently overestimated. In other cases, homeowners are turned down for loan modifications without any explanation. Some servicers are scrutinizing homeowner expenses and using back-end ratios as a basis for denying HAMP loan modifications. The lack of NPV transparency makes these actions hard to counteract. NPV turndowns must be detailed and in writing, and based on a transparent process that conforms to HAMP guidelines. While some servicers claim they are doing a large volume of modifications for homeowners not eligible for HAMP, as well as many HAMP loan modifications, the claim that homeowners are not eligible comes with no public accountability. In addition, some servicers represent themselves on their websites as participating, but fail to provide any HAMP review. Confusion as to coverage of affiliated servicers is widespread.