

Preserving Homeownership: Progress Needed to Prevent Foreclosures

Written Testimony

of

Diane E. Thompson
National Consumer Law Center

also on behalf of
National Association of Consumer Advocates

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Banking, Housing, & Urban Affairs

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I. Introduction

Chairman Dodd, Ranking Member Shelby, and members of the Committee, thank you for inviting me to testify today regarding the barriers encountered by homeowners attempting to access the Making Home Affordable program and the Hope for Homeowners program.

I am an attorney, currently of counsel to the National Consumer Law Center (NCLC).¹ In my work at NCLC I provide training and support to hundreds of attorneys representing homeowners from all across the country and consequently have heard many, many reports of the difficulties encountered by advocates and homeowners attempting to obtain sustainable loan modifications. For nearly 13 years prior to joining NCLC, I represented low-income homeowners at Land of Lincoln Legal Assistance Foundation in East St. Louis, Illinois. In that capacity, I became intimately familiar with the difficulties in arranging a loan modification, even when it was clearly in the investor's best interests.

I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services,

¹ The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (2d ed. 2007), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Alys Cohen, Staff Attorney, and Diane E. Thompson, Of Counsel, to NCLC.

government and private attorneys representing low-income consumers across the country. I also testify here today on behalf of the National Association of Consumer Advocates.²

We are facing in this country a foreclosure tsunami, which threatens to destabilize our entire economy, devastate entire communities, and destroy millions of families. Large-scale, sustainable modifications are widely recognized as an essential component of restoring economic health to our country and hope to our homeowners.

There are three major federal programs designed to prevent foreclosures and preserve homeownership: Hope for Homeowners, the Making Home Affordable refinance program, and the Making Home Affordable modification program, or the Home Affordable Modification Program. My comments will focus on the modification prong of the Making Home Affordable program. Far more of the homeowners facing foreclosure are eligible for modification under the Home Affordable Modification Program than for refinance under either Hope for Homeowners or the refinance prong of Making Home Affordable. Recent changes to both programs should increase eligibility and may increase participation. Still, restrictions on both programs are likely to continue to limit their reach.

Both Hope for Homeowners and the refinance prong of Making Home Affordable are designed to offer some relief to homeowners who owe more than their homes are worth. This is an important goal and an essential component of any solution to the foreclosure crisis. As described in Chairman Dodd's letter of July 10, 2009, Hope for Homeowners, in particular, could play an important role in

² The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

moving us forward by mandating principal reductions. We remain concerned, however, that neither program effectively eliminates negative equity. The refinance prong of Making Home Affordable permits the refinancing of excess debt and so may permit homeowners to lower interest rates. Absent market appreciation, however, it does not reduce the negative equity. Although Hope for Homeowners mandates principal reductions, many mortgage holders and servicers continue to be unwilling to agree to this write-down as the price for participation in the program, even with the possibility of an increased share in future appreciation.³ Nor is it clear that even the recent improvements to the Hope for Homeowners second lien program will be sufficient to remove second liens in any significant number.

The recent improvements to FHA and RHS are also beyond the scope of my testimony. We would like nonetheless to take this opportunity to congratulate Congress and the Administration on the important steps forward in these programs. In addition to improving Hope for Homeowners, S. 896 also increased the ability of homeowners with FHA and RHS loans to access partial claims, a special form of principal forbearance. This, too, is an important step to increase the long-term affordability of mortgages for many of our most vulnerable homeowners. Having negotiated partial claims with FHA servicers on behalf of low-income homeowners, I personally know how important the partial claim option can be to preserving homeownership. We at NCLC and NACA applaud Congress and the Administration for their efforts to expand the modification options available under the government-insured programs: FHA, RHS, and VA.

The Home Affordable Modification Program (HAMP) announced by President Obama's administration on March 4, 2009, is a laudable attempt to overcome long standing reluctance by

³ The requirement that future appreciation be shared with HUD also reduces homeowners' investment in their property and may have adverse unintended consequences if homeowners respond to that reduced equity by defaulting.

servicers to perform large numbers of sustainable loan modifications. HAMP seeks to change the dynamic that leads servicers to refuse even loan modifications that would be in the investors' best interests by providing both servicers and investors with payments to support successful loan modifications. Several months into the Home Affordable Modification Program (HAMP), however, homeowners and their advocates report that the program is not providing a sufficient number of loan modifications to homeowners, the modifications offered often do not meet the guidelines of the program, and the program itself still presents serious barriers to mass loan modifications.

HAMP, despite its lofty goals, has not yet been able to contain the foreclosure tsunami. To date, implementation of the program by servicers has been slow and sporadic. The Administration's efforts to hold servicers accountable⁴ are a welcome and necessary step forward. Further steps to reform HAMP and ensure servicer compliance are needed if the program is to reach its goal of reducing foreclosures. Particularly problematic is the lack of any mechanism to ensure that homeowners are, when appropriate, offered a loan modification prior to foreclosure sale. A timeline should be set to evaluate whether HAMP, along with other existing programs, can sufficiently address foreclosures. If it becomes clear they can not, more stringent measures, as discussed below, should be adopted. The structure of the servicing industry makes it unlikely that existing measures will be adequate; currently available information confirms that prognosis.

A. Problems with Servicers' Implementation of HAMP Plague Homeowners

Seeking Loan Modifications.

- ❖ Participating servicers violate the HAMP guidelines:

⁴ Renae Merle, *White House Prods Banks: Letter Tells Chiefs To Start Backing Mortgage Relief*, Wash. Post, July 10, 2009, available at http://www.washingtonpost.com/wp-dyn/content/article/2009/07/09/AR2009070902928.html?nav=rss_business.

- Servicers still require waivers.
 - Some participating servicers offer non-compliant loan modifications.
 - Some participating servicers refuse to offer HAMP modifications.
 - Servicers charge fees to homeowners for the modification.
 - Servicers are continuing to initiate foreclosures and sell homes at foreclosure sales while the HAMP review is pending.
- ❖ Servicer staffing and training still lag behind what is needed.
- Homeowners and counselors report waits of months to hear back on review for a trial modification, followed by very short time frames to return documents.
 - Staff of participating servicers continue to display alarming ignorance of HAMP.
 - Non-participating servicers continue to represent themselves as participating in HAMP.
- ❖ Lack of transparency and accountability is resulting in summary denials and other unreasonable acts by servicers.

B. Certain HAMP Policies Must Be Changed to Provide Sustainable Modifications and Save Communities.

- ❖ Transparency must be improved.
- The Net Present Value model for qualifying homeowners must be available to the public.
 - The layers of documents governing HAMP, the guidelines, the Supplemental Directives, the various FAQ's, and the servicer contracts, should be consolidated, reconciled, and clarified.

- Participating subsidiaries must be clearly identified.
- ❖ Mechanisms for enforcement and compliance should be adopted.
- All foreclosure proceedings must be stopped upon the initiation of a HAMP review, not just at the point before sale.
 - Homeowners should be provided with an independent review process when denied a loan modification.
 - Homeowners should have access to an ombudsman to address complaints about the process.
 - Denials based in part on a borrower's credit score should be accompanied by an adverse action notice under the Fair Credit Reporting Act.
- ❖ The HAMP guidelines should be adjusted to provide more meaningful relief to homeowners without reducing their existing rights.
- Homeowners need principal reductions, not forbearance.
 - Homeowners suffering an involuntary drop in income should be eligible for a second HAMP loan modification.
 - Homeowners in bankruptcy should be provided clear access to the HAMP program.
 - Mortgages should remain assumable as between spouses, children, and other persons with a homestead interest in the property.
 - Fair lending principles must be ensured throughout the HAMP process.
 - HAMP application procedures should better recognize and lessen the impact of exigent circumstances.

- The trial modification program should be further formalized and clarified, such that homeowners receive assurances of the terms of the permanent modification and homeowners are not put into default on their loans if they are current at the onset of the trial modification.
 - The final modification agreement should make clear that the homeowners do not waive any rights nor are required to reaffirm the debt in order to enter into the modification.
 - The second lien program should be further developed to promote coordination with first lien modifications; servicers should be required to participate in both programs.
- ❖ Data collection and reporting should provide broad, detailed information in order to support the best HAMP outcomes.

II. Foreclosures Far Outweigh Loan Modifications.

Goldman Sachs estimates that, starting at the end of the last quarter of 2008 through 2014, 13 million foreclosures will be started.⁵ At the end of the first quarter of 2009, more than 2 million houses were in foreclosure.⁶ Over twelve percent of all mortgages had payments past due or were in foreclosure and over seven percent were seriously delinquent—either in foreclosure or more than three months delinquent.⁷

⁵ Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), at 16; *see also* Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected 1* (Dec. 4, 2008) (predicting 9 million foreclosures for the period 2009-2012).

⁶ Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009) (reporting that 3.85% of 44,979,733, or 1.7 million, mortgages serviced were in foreclosure). Roughly half of these were serviced by national banks or federal thrifts. *See* Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 8 (June 2009), available at <http://files.ots.treas.gov/482047.pdf> (reporting that 884,389 foreclosures were in process by national banks and federal thrifts at the end of the first quarter of 2009). The estimate of more than 2 million homes in foreclosure is achieved by extrapolating from the MBA numbers. The MBA survey only covers approximately 80% of the mortgage market. Thus, $(44979733 * 3.85\%) / 0.8 = 2.16$ million.

⁷ Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009).

These spiraling foreclosures weaken the entire economy and devastate the communities in which they are concentrated.⁸ Neighbors lose equity;⁹ crime increases;¹⁰ tax revenue shrinks.¹¹

Communities of color remain at the epicenter of the crisis; targeted for subprime, abusive lending, they now suffer doubly from extraordinarily high rates of foreclosure and the assorted ills that come with foreclosure.¹²

⁸ See, e.g., Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* <http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12>; Ira J. Goldstein, The Reinvestment Fund, *Lost Values: A Study of Predatory Lending in Philadelphia*, at 62-/63 (2007), *available at* www.trfund.com/resource/downloads/policypubs/Lost_Values.pdf (discussing disastrous community impact left behind by failed subprime lenders).

⁹ See John P. Harding, Eric Rosenblatt, & Yao Vincent, *The Contagion Effect of Foreclosed Properties* (July 15, 2008), *available at* <http://ssrn.com/abstract=1160354>; Letter, Senator Dodd to Senator Reid (Jan. 22, 2008) (describing cycle of disinvestment, crime, falling property values and property tax collections resulting from foreclosures), *available at* http://dodd.senate.gov/multimedia/2008/012308_ReidLetter.pdf; Staff of the J. Economic. Comm., 110th Cong., 1st Sess., *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here* (2007), *available at* http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&Region_id=&Issue_id= (projecting foreclosed home owners will lose \$71 billion due to foreclosure crisis, neighbors will lose \$32 billion, and state and local governments will lose \$917 million in property tax revenue); Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 *Housing Pol'y Debate* 57, 69, 75 (2006) (“for each additional conventional foreclosure within an eighth of a mile of a house, property value is expected to decrease by 1.136 percent”; estimating total impact in Chicago to be between \$598 million and \$1.39 billion); William C. Apgar, Mark Duda, & Rochelle Nawrocki Gorey, *The Municipal Cost of Foreclosures: A Chicago Case Study* (Hous. Fin. Policy Research Paper 2005), at 1, *available at* www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf; John P. Harding, Eric Rosenblatt, & Yao Vincent, *The Contagion Effect of Foreclosed Properties* (July 15, 2008), *available at* <http://ssrn.com/abstract=1160354>; Letter, Senator Dodd to Senator Reid (Jan. 22, 2008) (describing cycle of disinvestment, crime, falling property values and property tax collections resulting from foreclosures), *available at* http://dodd.senate.gov/multimedia/2008/012308_ReidLetter.pdf.

¹⁰ See, e.g., J.W. Elphinstone, *After Foreclosure, Crime Moves In*, *Boston Globe*, Nov. 18, 2007 (describing Atlanta neighborhood now plagued by house fires, prostitution, vandalism and burglaries); Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 *Housing Stud.* 851 (2006), *available at* www.prism.gatech.edu/~di17/housingstudies.doc (calculating that for every 1% increase in the foreclosure rate in a census tract there is a corresponding 2% increase in the violent crime rate).

¹¹ See, e.g., Staff of the J. Economic Comm., 110th Cong., 1st Sess., *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here* (2007), *available at* http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&Region_id=&Issue_id= (projecting foreclosed home owners will lose \$71 billion due to foreclosure crisis, neighbors will lose \$32 billion, and state and local governments will lose \$917 million in property tax revenue); William C. Apgar, Mark Duda, & Rochelle Nawrocki Gorey, *The Municipal Cost of Foreclosures: A Chicago Case Study* (Hous. Fin. Policy Research Paper), 2005, at 1, *available at* www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf.

¹² See, e.g., Michael Powell & Janet Roberts, *Minorities Affected Most as New York Foreclosures Rise*, *N.Y. Times*, May 15, 2009; *Mortgage Foreclosure Filings in Pennsylvania: A Study by the Reinvestment Fund for the Pennsylvania Department of Banking* 36 (Mar. 2005), *available at* www.trfund.com/policy/pa_foreclosures.htm; Paul Calem, Kevin Gillen & Susan

Modifications have not made a dent in the burgeoning foreclosures. A recent paper in the Boston Federal Reserve Bank's Public Policy series found that less than eight percent of all the loans 60 days or more delinquent were modified during 2007-2008.¹³ Professor Alan White, in examining pools of securitized mortgages, found that the number of modifications varied dramatically by servicer, ranging from servicers who modified as many as 35 percent of the loans in foreclosure to as few as 0.28 percent of the loans in foreclosure in November 2008.¹⁴ Even at the high end of 35 percent of all mortgages in foreclosure, the modification rate is not enough to reduce the foreclosure rate to pre-crisis levels.¹⁵ HAMP has not yet improved the situation: although modifications increased during the first quarter of 2009, all data indicate that the number and rate of total modifications fell back during the second quarter.¹⁶

Worse, the modifications offered pre-HAMP (and presumably still by servicers not offering HAMP modifications) were overwhelmingly ones that increased the borrower's payment and principal

Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 J. Real Estate Fin. & Econ. 393 (2004); Ira Goldstein, The Reinvestment Fund, *Predatory Lending: An Approach to Identify and Understand Predatory Lending* (2002) (showing that areas within the City of Philadelphia that are predominately African American or Latino also tended to have higher concentrations of foreclosure sales and were more vulnerable to predatory lending); cf. AARP Pub. Pol'y Inst., *A First Look at Older Americans and the Mortgage Crisis* 5 (2008), http://assets.aarp.org/rgcenter/econ/i9_mortgage.pdf (African Americans and Hispanics are foreclosed on at roughly three times the rate of white Americans).

¹³ Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 35 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), available at <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf>.

¹⁴ Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Modification Contracts*, Conn. L. Rev. 12-13 (forthcoming 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1325534.

¹⁵ See Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., *Address at the Federal Reserve System Conference on Housing and Mortgage Markets* (Dec. 4, 2008), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12> (noting that the number of foreclosures has more than doubled from pre-crisis levels).

¹⁶ See, e.g., Gretchen Morgenson, *Fair Game—So Many Foreclosures, So Little Logic*, N.Y. Times, July 4, 2009 (reporting that modifications peaked in February 2009 and have since declined while the number of foreclosures and delinquencies has continued to rise); California Reinvestment Coalition, *The Ongoing Chasm Between Words and Deeds: Abusive Practices Continue to Harm Families and Communities in California* (2009) (reporting observations by housing counselors that loan modifications declined in the second quarter); *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White).

balance. Only about three percent of the delinquent loans studied in Boston Federal Reserve Bank paper received modifications that reduced the payment.¹⁷ Professor White's data shows that, in the aggregate, modifications increase the principal balance.¹⁸ While the first quarter 2009 data from the OCC and OTS shows that a majority of the modifications (excluding short term payment plans or forbearance agreements) decreased the payment, most of those modifications also increased the principal balance by capitalizing arrears.¹⁹ Unsurprisingly, redefault rates on loan modifications remain high.²⁰

The official numbers available to date on the HAMP program reflect a modest start at best.²¹ The good news is that, on paper at least, 75 percent of all the loans in the country should be covered by HAMP.²² The bad news is that only 55,000 trial modifications have been offered and only 300,000 letters with information about trial modifications have been sent to homeowners. As the President acknowledges, foreclosures still outnumber modifications under the program.²³ The 300,000 letters

¹⁷ Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), available at <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf>.

¹⁸ Alan White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports*, Fordham Urb. L. J. 20 (forthcoming 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259538#

¹⁹ Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 5 (June 2009), available at <http://files.ots.treas.gov/482047.pdf>.

²⁰ Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 6 (June 2009), available at <http://files.ots.treas.gov/482047.pdf>.

²¹ United States Department of the Treasury, *Making Home Affordable Progress Report*, May 14, 2009, available at <http://www.treas.gov/press/releases/docs/05142009ProgressReport.pdf>

²² United States Department of the Treasury, *Making Home Affordable Progress Report*, May 14, 2009, available at <http://www.treas.gov/press/releases/docs/05142009ProgressReport.pdf>.

²³ Tami Luhby, *Obama mortgage plan needs work: Many borrowers are not getting help under president's modification or refinancing plan*, CNN Money.com, July 8, 2009; Press Conference by the President, The White House, Office of the Press Secretary (June 23, 2009), available at http://www.whitehouse.gov/the_press_office/Press-Conference-by-the-President-6-23-09/ ("Our mortgage program has actually helped to modify mortgages for a lot of our people, but it hasn't been keeping pace with all the foreclosures that are taking place,").

containing information about trial modifications are obscured by the more than 2 million homeowners in foreclosure and the over 770,000 new foreclosure starts in the first quarter alone.²⁴

Servicers are still staffing up to deal with homeowners in distress.²⁵ Administration officials have admitted that the industry is not yet up to the task.²⁶ The progress servicers have made in hiring loan modification staff, although real, is not keeping up with the numbers of foreclosures filed by those same servicers.

We do not yet have any data on the characteristics or performance of the HAMP loan modifications. However, extensive reports from advocates around the country show that the quality of loan modifications offered too often does not comport with HAMP guidelines. Advocates for homeowners continue to report problems with implementation of the program.²⁷ Servicers are all too often refusing to do HAMP modifications, soliciting a waiver of homeowners' rights to a HAMP review, and structuring offered modifications in ways that violate HAMP. These violations may be harder to detect than the gross failure of servicers to date to process a meaningful number of modifications, but they will vitiate HAMP just as surely.

²⁴ Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009) (reporting that 3.85% of 44,979,733 mortgages surveyed were in foreclosure in the first quarter and that 1.37% of mortgages surveyed had foreclosure starts in the first quarter; the MBA survey data covers 80% of the mortgage market, so the numbers are extrapolated by dividing the MBA numbers by 80%).

²⁵ See, e.g., Peter S. Goodman, *Promised Help Is Elusive for Some Homeowners*, N.Y. Times, June 3, 2009.

²⁶ Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 29, 2009) (quoting Michael Barr, Assistant Secretary for Financial Institutions at the Treasury Department: "They need to do a much better job on the basic management and operational side of their firms . . . What we've been pushing the servicers to do is improve their infrastructure to make sure their call centers are doing a better job. The level of training is not there yet.").

²⁷ 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.

III. Servicers' Lack of Alignment with the Interests of Investors or Homeowners Contributes to the Failure to Do Loan Modifications.

As discussed above, despite widespread calls for more modifications, the number of modifications remains paltry compared to the number of foreclosures. And investors are losing mind-boggling large sums of money on foreclosures.²⁸ The available data suggests that investors lose ten times more on foreclosures than they do on modifications.²⁹

A. Servicers Have Different Interests Than Investors.

In attempting to make sense of this puzzle, we should remember that servicers are not investors. Investors hold the note, or a beneficial interest in it, and are, in general, entitled to repayment of the interest and principal. Servicers collect the payments from the homeowners on behalf of the investors. The bulk of their income comes from a percentage payment on the outstanding principal balance in the pool; the bulk of their net worth is tied to the value of the mortgage servicing rights they purchased. A servicer may or may not lose money—or lose it in the same amounts or on the same scale—when an investor loses money. And it is servicers, not investors, who are making the day-to-day, on the ground, decisions as to whether or not to modify any given loan.

Servicers continue to receive most of their income from acting as largely automated pass-through accounting entities, whose mechanical actions are performed offshore or by personified computer systems.³⁰ Their entire business model is predicated on making money by skimming profits from what they are collecting: through a fixed percentage of the total loan pool, fees charged

²⁸ *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White) (65% loss severity rates on foreclosures in June 2009).

²⁹ *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White).

³⁰ See, e.g., *In re Taylor*, 2009 WL 1885888 (Bankr.E.D.Pa. Apr 15, 2009).

homeowners for default, interest income on the payments during the time the servicer holds them before they are turned over to the owners, and affiliated business arrangements. Servicers make their money largely through lucky or strategic investment decisions: purchases of the right pool of mortgage servicing rights and the correct interest hedging decisions. Performing large numbers of loan modifications would cost servicers upfront money in fixed overhead costs, including staffing and physical infrastructure.

B. Servicers' Business Model Involves As Little Service As Possible.

As with all businesses, servicers add more to their bottom line to the extent that they can cut costs.³¹ Servicers have cut costs by relying more on voicemail systems and less on people to assist homeowners, by refusing to respond to homeowners' inquires and by failing to resolve borrower disputes. Servicers sometimes actively discourage homeowners from attempting to resolve matters. As one attorney in Michigan attempting to arrange a short sale with Litton reports, the voice mail warns "If you leave more than one message, you will be put at the end of the list of people we call back." Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate.³² As a result, servicers remain unable to provide affordable and sustainable loan modifications on the scale needed to address the current foreclosure crisis. Instead homeowners are being pushed into short-term modifications and unaffordable repayment plans.

³¹ See Joseph R. Mason, *Servicer Reporting Can Do More for Modification than Government Subsidies* 17 (Mar. 16, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1361331 (noting that "servicers' contribution to corporate profits is often . . . tied to their ability to keep operating costs low").

³² Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, *The Incentives of Mortgage Servicers: Myths and Realities* 9-10 (Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs Working Paper No. 2008-46); State Foreclosure Prevention Working Group, *Analysis of Subprime Mortgage Servicing Performance*, Data Report No. 3 at 8 (2008), <http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf>; Preston DuFauchard, California Department of Corporations, *Loss Mitigation Survey Results* 4 (Dec. 11, 2007); cf. Aashish Marfatia, Moody's, U.S. Subprime Market Update November 2007 at 3 (2008) (expressing concern as to servicers' abilities to meet staffing needs).

Creating affordable and sustainable loan modifications for distressed homeowners on a loan-by-loan basis is labor intensive.³³ Under many current pooling and servicing agreements, additional labor costs incurred by servicers engaged in this process are not compensated by the loan owner. By contrast, servicers' costs in pursuing a foreclosure are compensated. In a foreclosure, a servicer gets paid before an investor; in a loan modification, the investor will usually continue to get paid first. Under this cost and incentive structure, it is no surprise that servicers continue to push homeowners into less labor-intensive repayment plans, non-HAMP loan modifications, or foreclosure.

Post hoc reimbursement for individual loan modifications is not enough to induce servicers to change their existing business model. This business model—of fee-collecting and fee-skimming—has been extremely profitable. A change in the basic structure of the business model to active engagement with homeowners is unlikely to come by piecemeal tinkering with the incentive structure. Indeed, some of the attempts to adjust the incentive structure of servicers have resulted in confused and conflicting incentives, with servicers rewarded for some kinds of modifications, but not others,³⁴ or told both to proceed with a foreclosure and with a modification. Until recently, servicers received little if any explicit guidance on which modifications were appropriate and were largely left to their own devices in determining what modifications to make.³⁵ In the face of an entrenched and successful business model, fragmented oversight, and weak, inconsistent, and post hoc incentives,

³³ Joseph R. Mason, *Mortgage Loan Modification: Promises and Pitfalls* 7 (Oct. 3, 2007), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470.

³⁴ *See, e.g.*, Ben S. Bernanke, Chairman, Bd. of Governors of the Federal Reserve System, *Speech at the Federal Reserve System Conference on Housing and Mortgage Markets: Housing, Mortgage Markets, and Foreclosures* (Dec. 4, 2008), *available at* <http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm> (“The rules under which servicers operate do not always provide them with clear guidance or the appropriate incentives to undertake economically sensible modifications.”).

³⁵ American Securitization Forum, *Discussion Paper on the Impact of Forborne Principal on RMBS Transactions* 1 (June 18, 2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf.

servicers need powerful motivation to perform significant numbers of loan modifications. Servicers clearly have not yet received such powerful motivation.

Servicers may make a little money by making a loan modification, but it will definitely cost them something. On the other hand, failing to make a loan modification will not cost the servicer any significant amount out-of-pocket, whether the loan ends in foreclosure or cures on its own. Until servicers face large and significant costs for failing to make loan modifications, until servicers are actually at risk of losing money if they fail to make modifications, no incentive to make modifications will work. What is lacking in the system is not a carrot; what is lacking is a stick.³⁶

Servicers must be required to make modifications, where appropriate, and the penalties for failing to do so must be certain and substantial.

C. Servicers Maximize Income in Ways that Hurt Both Homeowners and Investors.

Servicers are designed to serve investors, not borrowers. Despite the important functions of mortgage servicers, homeowners have few market mechanisms to employ to ensure that their needs are met. Rather, in the interest of maximizing profits, servicers have engaged in a laundry list of bad behaviors, which have considerably exacerbated foreclosure rates, to the detriment of both investors and homeowners.³⁷

³⁶ See *Helping Families Save Their Homes: The Role of Bankruptcy Law: Hearing Before the S. Comm. on the Judiciary*, 110th Cong., 2nd Sess. (Nov. 19, 2008), *available*

http://judiciary.senate.gov/hearings/testimony.cfm?renderforprint=1&id=3598&wit_id=4083 (statement of Russ Feingold, Member, Sen. Comm. on the Judiciary) (“One thing that I think is not well understood is that because of the complex structure of these securitized mortgages that are at the root of the financial calamity the nation finds itself in, voluntary programs to readjust mortgages may simply be doomed to failure.”).

³⁷ See National Consumer Law Center, *Foreclosures*, Ch. 6 (2d ed. 2007 & Supp.) (describing the most common mortgage servicing abuses).

Most servicers derive the majority of their income based on a percentage of the outstanding loan principal balance.³⁸ For most pools, the servicer is entitled to take that compensation from the monthly collected payments, even before the highest-rated certificate holders are paid. The percentage is set in the PSA and can vary somewhat from pool to pool, but is generally 25 basis points for prime loans and 50 basis points for subprime loans.³⁹ This compensation may encourage servicers to refuse principal reductions and to seek capitalizations of arrears and other modifications that increase the principal balance.

Servicers also receive fees paid by homeowners and the “float”—the interest earned on funds they are holding prior to their disbursement to the trust.⁴⁰ For many subprime servicers, late fees alone constitute a significant fraction of their total income and profit.⁴¹ Servicers thus have an incentive to push homeowners into late payments and keep them there: if the loan pays late, the servicer is more likely to profit than if the loan is brought and maintained current. Float income encourages servicers to delay turning over payments to investors for as long as possible.

For servicers, their most important asset is the value of their mortgage servicing rights. Whether or not the servicer made the correct speculative investment decision when it bought the mortgage servicing rights to a pool of mortgages does more to shape its profitability than any other single factor. A servicer’s performance has only a marginal impact on the performance of the loan pool; the way a servicer increases its net worth is not by doing a top-notch job of servicing distressed

³⁸ See, e.g., Ocwen Fin. Corp., Annual Report (Form 10-K), at 3 (Mar. 17, 2008) (typically receive 50 basis points annually on the total outstanding principal balance of the pool).

³⁹ Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity & The Termination of Subprime Mortgages 2* (Fed. Res. Bank of St. Louis Working Paper No. 2006-024A); 26 NCLC Reports, *Follow the Money: How Servicers get Paid* May/June 2008..

⁴⁰ See generally *In re Stewart*, 391 B.R. 327, 336 (Bankr.E.D.La. 2008) (overviewing servicer compensation).

⁴¹ See, e.g., Ocwen Fin. Corp., Annual Report (Form 10-K), at 3 (Mar. 17, 2008); Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 Housing Pol’y Debate 753, 758 (2004).

mortgages but by gambling on market trends. Servicers with thin margins may need to squeeze all they can out of increasing performance from delinquent loans; servicers with stronger pools are likely to be less invested in the performance of the loans they manage.⁴² This dynamic leaves many servicers indifferent to the performance of the loans they service and unmotivated to hire and train the staff needed to improve performance.

D. The Possibility of Cure Does Not Explain Servicers' Failure to Make Loan Modifications in the Current Market.

A recent paper co-authored by my fellow panelist this morning, Paul Willen, confirms that extremely few loan modifications are being done and, in an attempt to solve the puzzle, propounds an economic model to explain the dearth of loan modifications.⁴³ Under the terms of that economic model, investors recover more if a borrower brings the loan current or refinances than if the lender modifies the loan. This is a commonsense and unobjectionable observation. Both the FDIC Loan Mod-in-a-Box NPV test and the HAMP NPV test build in the likelihood of cure in determining whether a loan modification or foreclosure is the more profitable path for investors.

In more normal times, it is surely rational for a servicer to spare itself the time and expense of modifying a loan in favor of the possibility of cure. In normal times, when cure rates exceeded

⁴² Vikas Bajaj & John Leland, *Modifying Mortgages Can Be Tricky*, N.Y. Times, Feb. 18, 2009 (reporting views of Credit Suisse analyst that “[s]maller companies . . . that are under more financial pressure and have more experience in dealing with higher-cost loans have been most aggressive in lowering payments” than larger companies, who offer weaker modifications).

⁴³ Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Defaults, Self-Cures, and Securitization* 35 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), available at <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf>. In addition to the overall limitations of a theoretical economic model to explain the complex web of interacting motivations impacting the numbers of loan modifications, there appear to be some errors in the model, even as a theoretical exercise. For example, the model assumes that the value of the unmodified loan is the greater of the unpaid principal balance or the value of the home, after adjusting for the costs of the foreclosure. But, in fact, it should be the lesser of the two. A foreclosing lender cannot legally recover more than the unpaid principal balance and is practically unlikely to recover more than the net foreclosure value of the home. This error results in an overstatement of the value of foreclosure, particularly in a market where home prices are declining, and thus undervalues modifications.

foreclosure rates, an investor would have little objection to the wait-and-see-approach.⁴⁴ However, this model cannot explain the failure to perform loan modifications when we observe real world conditions: dropping cure rates, due in part to the restricted ability to refinance, even for homeowners with high credit scores;⁴⁵ homes so deeply underwater that investors lose 65 percent of the mortgage debt on average in foreclosure;⁴⁶ and a lack of other, more attractive places, to invest funds. If we take the 30 percent cure rate documented for loans during 2007 and 2008 in the paper co-authored by Mr. Willen, assume, as the FDIC did in its NPV calculations, that 40 percent of all loan modifications will end in redefault, and assume loss severity ratios of 60 percent if the loan is foreclosed on immediately or 70 percent if it is foreclosed on after a redefault (to reflect the dropping home prices and potential loss of upkeep by a struggling homeowner), investors will still save money if loan modifications reduce the current present value of the loan by as much as 20 percent.⁴⁷

Mr. Willen and his co-authors suggest that the lack of outcry by investors against servicers demonstrates that servicers are acting in what the investors perceive as their best interest.⁴⁸ First, the premise that investors have been silent is not correct. Leading groups representing investors have

⁴⁴ Alan White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports*, Fordham Urb. L. J. 17-18 (forthcoming 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259538#; see also Aashish Marfatia, Moody's, U.S. Subprime Market Update November 2007 at 5 (2008) (reporting that half of all active loans facing reset in the first three-quarters of 2007 refinanced; more than one-quarter of all remaining loans refinanced after reset); State Foreclosure Prevention Working Group, *Analysis of Subprime Mortgage Servicing Performance*, Data Report No. 3 at 8 (2008), <http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf> (reporting that 23% of closed loss mitigation efforts in May 2008 were either refinancings or reinstatements in full by the borrower).

⁴⁵ David Streitfeld, *Tight Mortgage Rules Exclude Even Good Risks*, N.Y. Times, July 10, 2009.

⁴⁶ *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White).

⁴⁷ These numbers are derived from an analysis by Professor Alan White. His comment on the study is Attachment E of this testimony.

⁴⁸ Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Defaults, Self-Cures, and Securitization* 24 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), available at <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf>.

urged more and deeper loan modifications.⁴⁹ Second, to the extent that some investors have been silent, we cannot assume that their silence means that they are happy with servicers' actions. Given the lack of effective control investors exercise over servicers, it would be wrong to construe that silence as agreement with servicers' decisions to decline modifications in favor of a chimerical cure. The large, private-label pools that contain most subprime loans are passive investment vehicles. Trustees, on behalf of the trust, can in exceptional cases fire a servicer, but this right is rarely invoked, usually only when the servicer is no longer able to pay the advances due on the borrowers' monthly payments.⁵⁰ Thus, although servicers are nominally accountable to investors, investors are, in most cases, no more powerful than borrowers to provide direction to a servicer.⁵¹

The work of Mr. Willen and his co-authors is an important contribution to understanding the nature and quantity of the loan modifications performed. The study does not tell us why loan modifications are not being done, however. The study does not run actual net present value analyses on actual loans: many loans that it would not make sense to modify in a market with rising home prices, easy refinancing, and plentiful alternative investment channels do make sense, purely from the standpoint of financial return to investors, to modify in today's economic market. The paper presents no hard data on whether or not servicers, in this climate, are serving the best interests of investors in refusing to modify loans. Servicers, moreover, may have different incentives than investors, and it is not clear that servicers do always make loan modification based upon the best interests of the trust as a whole.

⁴⁹ See, e.g., American Securitization Forum, Statement of Principles, Recommendations, and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans 2 (June 2007).

⁵⁰ Indeed, PSAs usually allow a trustee to increase its monitoring of a servicer only in the case of a narrowly circumscribed list of triggering events, primarily financial defaults. Michael Laidlaw, Stephanie Whited, Mary Kelsch, Fitch Ratings, U.S. Residential Mortgage Servicer Bankruptcies, Defaults, Terminations, and Transfers 2 (2007).

⁵¹ See, e.g., Joseph R. Mason, Servicer Reporting Can Do More for Modification than Government Subsidies 14 (Mar. 16, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1361331 ("The point is, the investor has to completely trust the servicer to act in their behalf, often in substantially unverifiable dimensions.").

What we know from this study is that servicers are not making modifications. We believe that more modifications could be made that would serve the interests of both investors and homeowners, as well as the national economy. As Professor Alan White noted in his testimony last week before a House subcommittee,⁵² and as the authors acknowledge,⁵³ there may be compelling public policy reasons to increase the number of modifications. Foreclosures impose high costs on families, neighbors, extended communities, and ultimately our economy at large.⁵⁴ It would be short-sighted indeed to fail to act.

IV. HAMP Design and Implementation Present Substantial Barriers to High Volume, High Quality Loan Modifications

HAMP offers real hope for increasing both the quantity and the quality of loan modifications made. By mandating a take-one, take-all policy, requiring servicers of GSE loans to modify loans, and standardizing the loan modification process, HAMP should increase the total number of modifications. By mandating affordable payments, limiting the fees charged, and permitting principal reductions, HAMP will increase the quality of the loan modifications offered.

HAMP is a significant step forward from previous loan modification programs. Yet the program has significant limitations both in design and implementation. HAMP's ability to guarantee an increase in sustainable modifications is dependent on voluntary servicer participation in the

⁵² *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White).

⁵³ Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 8 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), available at <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf>.

⁵⁴ Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12>

program. Several large servicers are still not participating, and the patchwork coverage is confusing to homeowners and their advocates alike.

More seriously, homeowners have no leverage to obtain a HAMP loan modification from even a participating servicer. It is unclear if the Administration's compliance efforts will be able to detect and remedy servicer noncompliance. Similarly, whether or not HAMP's equalization of the incentives between principal and interest rate reductions will be enough to boost the number of modifications that reduce principal remains to be seen. Since loan modifications with principal reductions appear to have the lowest redefault rates,⁵⁵ HAMP's long-term success may be contingent on increasing the number of loan modifications with principal reductions and its great weakness in ensuring sustainable modifications may be its failure to mandate principal reductions.

A. Problems with Servicers' Implementation of HAMP Plague Homeowners

Seeking Loan Modifications.

Servicers' compliance with HAMP is, at best, erratic. There is widespread violation of the HAMP guidelines across many servicers. The lack of compliance arises in part from obvious and persistent short falls in staffing and training. Yet some of the violations of HAMP are embodied in form documents, perhaps reflecting a more conscious attempt to evade the HAMP requirements. Lack of transparency prevents homeowners from identifying violations. Lack of accountability prevents homeowners from obtaining any redress when violations are identified.

1. Participating servicers violate existing HAMP guidelines.

⁵⁵ See, e.g., Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, *Loan Modifications and Redefault Risk: An Examination of Short-Term Impact* (Center for Community Capital, March 2009), available at http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf.

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

The HAMP rollout language prohibits waivers of legal rights. Yet servicers still are seeking waivers from homeowners or an admission of default.⁵⁶ We have learned of many instances in which servicers require homeowners to waive all claims and defenses in order to obtain a loan modification or even a loan modification review. Servicers also have asked homeowners to waive their right to a HAMP loan modification review in favor of a non-HAMP loan modification.⁵⁷ 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.⁵⁸ These are form documents and thus unlikely to represent a random mistake by a line-level employee.

Some participating servicers offer non-compliant loan modifications.

All homeowners who request a HAMP review are entitled to one. Homeowners may elect a non-HAMP modification, but that should be the borrower's choice, informed by disclosure of all modification options.

Nonetheless, some servicers have told homeowners that they are providing a HAMP modification, only to provide documents that do not comport with the HAMP guidelines. These loan modifications are usually significantly less sustainable than a HAMP modification would be and often have higher costs. In addition to the waiver issue discussed above, advocates have been told

⁵⁶ See Attachment A, Ocwen Loan Servicing Loan Modification Agreement dated June 1, 2009 (seeking waiver of all legal rights by homeowner) Attachment B, Aurora Loan Services "workout agreement" dated May 20, 2009 (seeking homeowner admission of default and stating that the trial payments will not remove the homeowner from delinquency).

⁵⁷ See, e.g., Attachment C (Chase Agreement seeking to obtain waiver of homeowner's right to a HAMP loan modification in favor of a non-HAMP loan modification offered prior to March 4, 2009).

⁵⁸ See, e.g., Attachment D (WaMu HAMP trial plan agreement requiring waiver of HAMP loan modification if homeowner later enters bankruptcy).

that homeowners must pay large advance fees before a modification will be considered, homeowners have been required to complete hefty repayment plans before a review is conducted, and homeowners have been offered, as HAMP modifications, modifications limited to five years, with no limitation on interest rate increases after that time. Aurora, for example, represented to one advocate that it does not have the “right documents,” although they have been publicly available for months, and so instead offered the borrowers old forms that contain waivers and are otherwise not HAMP compliant. Select Portfolio Servicing has insisted that a New York borrower make payments at a 44 percent debt-to-income ratio instead of the 31 percent mandated by HAMP.

Some participating servicers refuse to offer HAMP modifications.

The HAMP servicer contracts require that participating servicers review all homeowners in default for HAMP eligibility and that any borrower who requests a HAMP review be granted one, even if the borrower is not yet in default. Homeowners not yet in default but who are at imminent risk of default are eligible for a HAMP modification. Servicers may only refuse to perform a HAMP review if the pooling and servicing agreement (PSA) forbids modification. In that case, servicers are still expected to use all reasonable efforts to obtain an exception to the PSA.

Staff at some participating servicers routinely refuse to do HAMP loan modifications.⁵⁹ For example, in a New York case, the employee stated that the investor did not permit loan modifications, yet refused to produce a copy of the PSA or even identify the investor, much less attempt to obtain a release from the restrictions as required by HAMP. One California advocate pursuing a HAMP modification for a loan serviced by Wells Fargo was told repeatedly that the

⁵⁹ See, e.g., *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?* Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 111th Cong. (2009) (testimony of Irwin Trauss) (Saxon Mortgage “simply reject[s] homeowners for consideration under HAMP, for no reason that is in any way connected with the program requirements, with no notice of any kind to the homeowner or to her counsel.”).

holder did not do modifications. After protracted discovery, the servicer identified the holder as Wells Fargo Home Mortgage. Wells Fargo Home Mortgage, of course, is owned by Wells Fargo Bank, a participating servicer under HAMP. In another case, a Select Portfolio Servicing representative said that the PSA prevented a HAMP modification, but could not provide the PSA due to “system errors.” Other times servicers tell homeowners that they are not participating or that they are only participating for GSE loans. Bank of America has told homeowners in both Pennsylvania and Florida that it is only modifying loans that are owned by the GSEs.⁶⁰ Bank of America is a participating servicer under HAMP and therefore required to evaluate all loans for modification under HAMP. Some servicers have asserted that loans held by the GSEs require a higher debt-to-income ratio than HAMP, despite the implementation of nearly identical programs by both Fannie Mae and Freddie Mac. Advocates in both Ohio and Florida have been driven to file court documents to compel Wells Fargo to do a HAMP review and stay foreclosure proceedings, after Wells Fargo failed to complete a HAMP review.⁶¹

HAMP may even be causing a drop off in loan modifications. Loan modifications rose through the first quarter of the year, but fell after HAMP’s roll out in March.⁶² Bank of America informed an advocate that future HAMP modifications are put on hold while Treasury reviews Bank of America’s version of the Net Present Value calculation. Other advocates and homeowners have been told more generally that their servicer is participating but that the servicer does not yet have a program to evaluate homeowners for HAMP. Ocwen, for example, told an advocate on July 1 that it did not know when it would be rolling out its HAMP modifications. Ocwen signed a contract as a

⁶⁰ See, e.g., *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?* Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 111th Cong. (2009) (testimony of Irwin Trauss).

⁶¹ Motion to Set Aside the Judgment, Modify the Loan, and Dismiss the Foreclosure, U.S. Bank National Ass’n as Trustee HEAT 2006-1 v. Pitman, No. 2008-CV-337 (Greene County, Ohio, 2009); Motion to Stay/Abate, Deutsche Bank Nat’l Trust Company, as Trustee for HIS Asset Securitization Trust 2007-HE1 v. Hoyne, No. 42-2009-CA-002178 (Marion County, Fla., 2009).

⁶² Gretchen Morgenson, *Fair Game—So Many Foreclosures, So Little Logic*, N.Y. Times, July 4, 2009

participating servicer on April 16, two and a half months earlier. One Brooklyn, New York advocate was told that the investor was not allowing any modifications because they were waiting for the federal government to act. In the meantime, of course, foreclosures continue.

Servicers charge fees to homeowners for the modification.

HAMP forbids any upfront payments as a precondition to review or trial modification. Several homeowners have reported being told by various servicers that they must make payments before being considered for HAMP.⁶³ Sometimes these payments take the form of a special forbearance agreement or lump-sum payment of arrearages; other times it is less clear what the payment is for. A Bank of America loss mitigation representative informed a Pennsylvania homeowner's counsel that if the homeowners paid \$2,200.00 to Bank of America, then Bank of America would "consider" a loan modification. America's Servicing Company, a division of Wells Fargo Home Mortgage, told a New York borrower that only upon completion of a three month repayment plan, followed by a balloon payment of \$18,000, could the borrower be considered for HAMP. Select Portfolio Servicing representatives demanded a payment in the amount of the original mortgage payment in order to enter the trial period agreement in order to demonstrate the borrower's "good faith."

Servicers are continuing to initiate foreclosures and sell homes at foreclosure sales while the HAMP review is pending.

HAMP requires that no foreclosures be initiated and no foreclosure sales be completed during a HAMP review, although existing foreclosure actions may be pursued to the point of sale. Reports from around the country indicate that servicers are routinely placing homeowners into foreclosure during a HAMP review and, far worse, selling the home at foreclosure while the homeowner is waiting on the outcome of the HAMP review.

⁶³ See, e.g., Attachment A, Ocwen Loan Servicing Loan Modification Agreement dated June 1, 2009.

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

2. Servicer staffing and training still lag behind what is needed.

Homeowners encounter numerous bureaucratic barriers in attempting to negotiate a loan modification.

Homeowners' loan files are routinely lost.⁶⁴ Counselors report waits of months to hear back on review for a trial modification. In one case, Select Portfolio Services advised counsel for a New York borrower on three separate occasions over six weeks that the necessary broker price opinion had been cancelled due to "system errors" and a new request would have to be submitted. A Florida homeowner had his HAMP trial modification cancelled by Citimortgage for non-compliance, despite having submitted all required documents and payments as required, only to receive a HAMP solicitation letter the same day. His lawyer, in describing the situation to us, wrote, "It is driving the poor guy bananas."

To add insult to injury, homeowners are expected to return the documents within days of receipt. Homeowners in both New York and Florida have reported receiving the trial modification agreements the same day the servicer required their return. One Illinois homeowner received her trial modification agreement three days after she was required to return the agreement.

Staff of participating servicers continue to display alarming ignorance of HAMP.

⁶⁴ Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 28, 2009.

Staff of participating servicers have told homeowners that HAMP does not exist. Several homeowners have reported being told to contact HUD since HAMP is a government program. HUD, of course, does not administer HAMP; participating servicers do. Bank of America apparently told the homeowners in one case that they were not eligible for HAMP because they were not in default.⁶⁵ This misinformation was given to the homeowner despite the fact that servicers are given an additional \$500 incentive payment for modifying a loan prior to default. In another case, Bank of America refused to modify a first lien position home equity line of credit, apparently under the belief that modifications of home equity lines of credit were banned as second liens, whether or not they actually were junior liens.

In one case, Select Portfolio Servicing (SPS) claimed that it could only take 80% of the applicants' gross income into consideration, regardless of HAMP guidelines and that the clients would have to reduce their debt obligations by \$300 to be considered for a modification. The representatives appeared to be operating under SPS's standard screening process for non-HAMP modifications and were not familiar with the HAMP standards. In the same case, another SPS representative claimed that the investor on the loan would only allow for payment modifications at 44 percent debt-to-income ratio, not the 31 percent mandated by HAMP. In many cases, it is not clear if staff are applying the net present value test or if they are applying it correctly.⁶⁶

A recent blurb from *Mortgage Servicing News Bulletin* captures the problem: "Confused About the Rescue Plan?"⁶⁷ Apparently many servicers are.

⁶⁵ Freda R. Savana, *Some Banks Not With the Program*, Bucks County Courier Intelligencer, July 14, 2009.

⁶⁶ See, e.g., *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?* Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 111th Cong. (2009) (testimony of Irwin Trauss) (discussing a case involving Wells Fargo).

⁶⁷ Mortgage Servicing News Bull., July 14, 2009.

Non-participating servicers continue to represent themselves as participating in HAMP.

Some servicers give conflicting information on whether or not they participate in HAMP. American Home Mortgage Servicing, for example, conveyed on its web site, automated answering service, and through its loan modification staff that it was a participating servicer under HAMP. Yet at least some of the loan modifications it offered were not HAMP-compliant, nor is it, as of July 13, 2009, listed as a participating servicer.

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

Even when servicers do a HAMP review, they sometimes use the wrong numbers, which advocates are only able to uncover after a protracted battle. In one case involving a New York borrower, Select Portfolio Servicing representatives initially advised that the clients were ineligible for a HAMP loan modification, based on their budget. When asked for clarification about the grounds for this determination, SPS representatives claimed that the clients' expenses exceeded their income, making it impossible for them to afford their mortgage. Upon further discussion, it was revealed that SPS was using the clients' original mortgage payment as an input value for these calculations, rather than the proposed modified payment amount that would have made their mortgage affordable.

Some servicers are scrutinizing homeowner expenses and using back-end ratios as a basis for denying HAMP loan modifications. Back-end ratios, the ratio between all of the borrowers' fixed monthly obligations and income, should not disqualify a borrower under HAMP unless the reduced payment will cause the borrower severe financial hardship; instead, homeowners with back-end

ratios above 55 percent are to be referred to HUD-certified housing counselors. In other cases, homeowners are turned down for loan modifications without any explanation.

Servicers refuse to provide the final payment amounts even when the borrower provides all verified information before the beginning of the trial modification period. In one case, three days after the servicer had supplied the borrower with the first set of trial modification documents and nearly two months after the borrower had submitted verified income information, the servicer increased the monthly payment amount, without any apparent justification.

The permanent modifications offered often include arrears that are undocumented and apparently overestimated. While HAMP permits arrearages and some fees to be capitalized, HAMP does not permit unpaid late fees to be capitalized. Given the widespread practice by servicers of padding fees in foreclosure or bankruptcy,⁶⁸ homeowners and their advocates have good reason to seek review of the legitimacy of the fees.

Some servicers claim they are doing a large volume of modifications for homeowners not eligible for HAMP, as well as many HAMP loan modifications. Whether or not the homeowners with the non-HAMP modifications were in fact eligible for HAMP is uncertain. As discussed above and exemplified in Attachment C, some servicers are requiring homeowners to waive their eligibility for a HAMP review in order to obtain any modification. The lack of public accountability makes it impossible to know how many of those reported as ineligible for HAMP were, in fact, ineligible, and how many were simply steered away from HAMP modifications.

⁶⁸ See, e.g., *In re Stewart*, 391 B.R. 327 (Bankr. E.D. La. 2008); *In re Sacko*, 394 B.R. 90 (Bankr. E.D. Pa. 2008); *In re Prevo*, 394 B.R. 847 (Bankr. S.D. Tex. 2008); *In re Porter*, 399 B.R. 113 (Bankr. D. N.H. 2008); Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev 121 (2009).

In addition, determining whether or not any individual servicer is or is not participating is not trivial. As discussed above, some servicers represent themselves on their websites as participating, but fail to provide any HAMP review. As discussed below, confusion as to coverage of affiliated servicers is widespread.

B. Certain HAMP Policies Must Be Changed to Provide Sustainable Modifications and Save Communities.

1. Transparency must be improved.

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.⁶⁹ 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.

⁶⁹ 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.

The lack of NPV transparency makes servicer turn-downs hard to counteract. NPV turn-downs must be detailed and in writing, and based on a transparent process that conforms to HAMP guidelines.

The layers of documents governing HAMP, the guidelines, the Supplemental Directives, the various FAQ's, and the servicer contracts, should be consolidated, reconciled, and clarified.

Homeowners, their advocates, and servicers have no one source of guidance on HAMP. The initial guidelines differ slightly from the Supplemental Directives, and the FAQs provide different interpretations. All of this complicates compliance.

Participating subsidiaries must be clearly identified

Participating servicers may, but need not, require their subsidiaries to participate, so long as the subsidiary is a distinct legal entity. However, if the subsidiary is not a distinct legal entity, then the subsidiary must participate. The public list of participating servicers still does not make these distinctions clear. One example of the confusion is Wells Fargo. On financialstability.gov, Wells Fargo Bank is listed as a participating servicer. Wells Fargo Bank, N.A., is, according to the National Information Center maintained by the Federal Reserve, the parent company of Wells Fargo Home Mortgage. The contract posted on financialstability.gov variously represents the covered servicer as Wells Fargo Bank, N.A. (when giving the address for notices) and Wells Fargo Home Mortgage, a division of Wells Fargo Bank, N.A. (above the signature lines). Does this contract mean that both Wells Fargo Bank, N.A., and Wells Fargo Home Mortgage are covered? And is America's Servicing Company, a division of Wells Fargo Home Mortgage also covered? The answer to both questions

appears to be yes but has not been uncontested. Asking homeowners and counselors to wade through these legal relationships invites confusion and frustration.⁷⁰

2. Mechanisms for enforcement and compliance should be adopted.

All foreclosure proceedings must be stopped upon the initiation of a HAMP review, 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 above), 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 thousands of dollars in foreclosure 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. Staying the foreclosures during the pendency of a HAMP review would encourage servicers to expedite their HAMP reviews, rather than delaying them.

Homeowners should be provided with an independent review process when denied a loan modification.

It seems unlikely that all servicers will always accurately evaluate the qualifications of every homeowner who is eligible for HAMP. Homeowners who are wrongly denied must be afforded an independent review process to review and challenge the servicer's determination that the borrower does not qualify for HAMP.

⁷⁰ We understand and appreciate that the Treasury Department is working on this issue. As is apparent, providing full information to the public on participating servicers is essential.

Homeowners should have access to an ombudsman to address complaints about the process.

Homeowners currently have no resource for addressing complaints, whether with a servicer's failure to return phone calls or offer of a non-compliant modification. Any forum for addressing homeowners' complaints must adhere to time lines for addressing complaints and provide public accounting as to the nature of the disputes and their resolution.

Denials based in part on a borrower's credit score should be accompanied by an adverse action notice under the Fair Credit Reporting Act.

The Fair Credit Reporting Act requires that if an adverse action in the provision of credit is taken based in part on the borrower's credit score that the borrower be advised of that adverse action and of the credit score upon which the decision was based.⁷¹ The reason for that requirement is that credit scores often have errors, which a borrower may correct—but only if the borrower is aware of the error.

The Net Present Value test relies on credit scores to determine default and redefault rates. It is at least possible that those credit scores could result in the failure of the NPV test and the denial of a loan modification. Absent full transparency regarding the NPV calculation, homeowners are unlikely to know of the program's reliance on their FICO score or, if they do, whether or not their FICO score was the cause of their denial for a HAMP modification. An adverse action notice alerts homeowners to the possibility that an incorrect FICO score—which could be corrected—might be the reason their servicer denied a HAMP modification. Without an adverse action notice homeowners have little opportunity to address any potential problems.

⁷¹ 15 U.S.C. §1681m.

3. The HAMP guidelines should be adjusted to provide more meaningful relief to homeowners without reducing their existing rights.

Homeowners need principal reductions, not forbearance.

Principal forgiveness is necessary to make loan modifications affordable for some homeowners. A significant fraction of homeowners owe more than their homes are worth.⁷² 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 loans that negatively amortize until as much as 125 percent of the original balance is owed; or 2) obtained loans that were based on inflated appraisals. As a matter of equity and commonsense, homeowners should not be trapped in debt peonage, unable to refinance or sell.

Practically, principal reductions may be key to the success of HAMP. Being “underwater” increases the risk of default, particularly when coupled with unaffordable payments.⁷³ Built into the HAMP NPV calculations is an assumption that default increases as a function of how far underwater the homeowner is. Existing data on loan modifications shows that loan modifications with principal reductions tend to perform better.⁷⁴ In order to bring down the redefault rate and make loan modifications financially viable for investors, principal reductions must be part of the package.

The Federal Reserve Board’s loan modification program directly requires principal reductions for those homeowners most underwater. Under that program, principal reductions are mandated when the outstanding loan balance exceeds 125 percent of the home’s current market value. Not

⁷² See Renae Merle & Dina ElBoghdady, *Administration Fills in Mortgage Rescue Details*, Wash. Post, Mar. 5, 2009 (reporting that one in five homeowners with a mortgage owe more on their mortgages than their home is worth).

⁷³ See, e.g., Kristopher Gerardi, Christopher L. Foote, & Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence* (Fed. Reserve Bank of Boston Pub. Pol’y Paper No. 08-3, June 2008); Andrey Pavlov & Susan Wachter, *Aggressive Lending and Real Estate Markets* (Dec. 20, 2006), available at <http://realestate.wharton.upenn.edu/newsletter/pdf/feb07.pdf>.

⁷⁴ Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, *Loan Modifications and Redefault Risk: An Examination of Short-Term Impact* (Center for Community Capital, March 2009), available at http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf.

incidentally, under the most recent revisions to the Making Home Affordable refinance program, once the mark-to-market loan-to-value ratio is 125 percent, a homeowner may refinance. Thus, once the loan value is reduced to 125 percent of current market valuation, there is, at least for some homeowners, the possibility of refinancing. While a loan-to-value ratio of 125 percent still leaves homeowners underwater and restricts their options, it gives them some hope, as it permits the possibility of refinancing or even sale, after several years of payments or subsequent to a market rebound. A reduction only to 125 percent is still sufficiently harsh that it is likely to contain any moral hazard problems, yet it puts a finite bound on the homeowner's debt peonage.

HAMP permits principal reductions, but does not mandate them, not even in the most extreme cases. HAMP does require forbearance, but only as a method for reducing payments. 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. For all of these reasons, the HAMP guidelines should be revised so that they at least conform to the Federal Reserve Board's loan modification program by reducing loan balances to 125 percent of the home's current market value.

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

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 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 HAMP modifications, homeowners generally are being denied such modifications. In at least one instance, a servicer is reported to have refused a modification on the basis of a former bankruptcy, a clear violation of the HAMP guidance. The HAMP guidelines should provide clear guidance on instances where a loan modification should be provided to homeowners in 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.

Some servicers have explained their reluctance to do loan modifications in bankruptcy by citing a fear of violating the automatic stay in bankruptcy. Neither the automatic stay nor the discharge order should be a bar to offering an otherwise eligible homeowner a loan modification. HUD, in recent guidance to FHA servicers, has explicitly recognized that offering a loan modification does not violate the automatic stay or a discharge order.⁷⁵

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

⁷⁵ HUD Mortgagee Letter 2008-32, October 17, 2008.

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.

Two changes to the modification rules should also be made to facilitate access for homeowners in bankruptcy. First, the payment rules should take into account the fact that payments may be passed through the bankruptcy trustee, rather than directly from homeowner to servicer. Supplemental Directive 09-03 requires that the servicer receive a payment by the end of the first month that the trial plan is in effect. If the servicer does not receive the payment, the trial modification is terminated and the homeowner is disqualified from a permanent modification under HAMP. There is often an initial lag between passing the payments from the bankruptcy trustee to the servicer; homeowners should not be penalized for a delay over which they have no control and which is occasioned solely by their exercise of their right to file bankruptcy.

Second, the modification documents should explicitly prohibit servicers from requiring homeowners to reaffirm mortgage debts. Although the guidance and supplemental directive appear to allow homeowners not to reaffirm in bankruptcy, the form modification agreement requires reaffirmation

by its terms in paragraph 4E. The modification agreement should be amended to restate explicitly that the borrower does not waive any claims by entering into the modification and that no reaffirmation of the debt is required. Because reaffirmations of home mortgages have the potential to deny homeowners a fresh start, many bankruptcy judges refuse to approve them. Congress recognized this concern with an amendment to the Bankruptcy Code in 2005 that permits mortgages to be serviced in the normal course after bankruptcy even if the mortgage has not been reaffirmed. These purported reaffirmation agreements made outside the mandatory notice and review procedures of section 523(c) and (d) of the Bankruptcy Code have no effect, are not enforceable, and the government should not be involved in encouraging the practice.

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.⁷⁶ Such transfers are most likely to occur upon death or divorce. They may also occur in the context of domestic violence. Freddie Mac has long allowed mortgage assumptions by relatives as one method of working out delinquent mortgages.

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.

Fair lending principles must be ensured throughout the HAMP process.

⁷⁶ 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).

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 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 and 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 trial modification program should be further formalized and clarified, such that homeowners receive assurances of the terms of the permanent modification and homeowners are not put into default on their loans if they are current at the onset of the trial modification.

The trial modification program currently complicates matters for participating homeowners by increasing costs and failing to maximize the chances for long-term success. Moreover, by binding homeowners but not servicers, it may further discourage some homeowners from participating.

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; this may register as a black mark against their credit. Homeowners 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 borrower is required to sign the trial modification documents, but the servicer is not. This one-sided contract discourages some homeowners and advocates. Homeowners may decide that the costs of a trial modification—the capitalized interest, the sunk payments, the potential adverse credit reporting—are not worth the uncertain benefit of a permanent modification. Some servicers compound this problem by telling homeowners seeking modifications that they are under no obligation to offer a permanent modification. Indeed, the trial modification agreement itself, in paragraph 2F, appears to allow servicers to choose not to complete a permanent modification. According to paragraph 2F, homeowners are not entitled to a permanent modification if the servicer fails to provide the borrower with “a fully executed copy of this Plan and the Modification Agreement.” Should a servicer fail to provide the borrower with a fully executed copy, the borrower is left without a permanent modification and without any recourse, while the servicer may then retain the payments made and proceed to a foreclosure. Faced with this uneven exchange, many homeowners will rationally refuse to complete a trial modification, even if they would qualify for and benefit from a permanent modification.

The final modification agreement should make clear that the homeowners do not waive any rights nor are required to reaffirm the debt in order to enter into the modification.

Although the HAMP guidelines prohibit waiver of claims and defenses,⁷⁷ the language in paragraph 4E of the modification agreement, “[t]hat the Loan Documents are composed of duly valid, binding agreements, enforceable in accordance with their terms and are hereby reaffirmed,” could be construed as a waiver of some claims, particularly claims involving fraud in the origination or execution of the documents. In addition to the problems posed by reaffirmation of the debt in bankruptcy, reaffirmation of the debt and loan documents outside of bankruptcy could be construed as a waiver of defenses to the debt. Servicers, as discussed above and demonstrated by the attachments, are seeking even stronger waivers of legal rights; the form documents should give such unauthorized behavior no shelter. The modification agreement should clearly state that the borrower does not waive any claims and defenses by entering into the agreement and that the borrower is not required to reaffirm the debt.

The second lien program should be further developed to promote coordination with first lien modifications; servicers should be required to participate in both programs.

Servicers continue to express ignorance of the second lien program and widely refuse to modify second liens. For example, Bank of America told a Pennsylvania borrower that a home equity line of credit could not be modified because it was “written” as a second lien, even though it was the primary, and only, lien against the property.

Servicers will often service both the first and second liens. Frequently, servicers themselves hold the second lien. Yet often servicers refuse to address the second lien, despite the incentives in HAMP to do so. Servicers who hold second liens may prefer to gamble on a market recovery rather than

⁷⁷ Supplemental Directive, 09-01, at 2, *available at* hmpadmin.com.

accept the incentive payments under HAMP and recognize their losses now. Many servicers will choose not to participate in the second lien program absent a federal mandate.

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.

4. Data collection and reporting should support the best HAMP outcomes possible.

The maximum amount of data should be made available to the public, including data on a loan-by-loan basis. The data should be made available in user-friendly formats that are easy to obtain and that allow for additional and varied processing and analysis. The data should be made available on a basis as close to real time as possible. Data collected by the government and disclosed to the public, including HAMP monitoring data and other data, should enable the government and the public to compare the performance of HAMP against specific benchmarks. The data should enable the government and the public to assess the extent to which HAMP is serving equitably those most heavily targeted for high risk loans (especially African-American, Latino and older borrowers).

V. Benchmarks for Performance, Mandatory Loan Modification Offers, and Other Servicing Reforms Should Be Required If the Program Does Not Produce Sufficient Results in Short Order.

Creating affordable and sustainable loan modifications for distressed homeowners is labor intensive. It is no surprise, then, that servicers continue to push homeowners away from HAMP loan modifications or delay the process substantially.

Initial data collection will make a more exact review of the HAMP program possible within the next few months. Freddie Mac already is engaged in substantial oversight. Our work nationwide on behalf of homeowners facing foreclosure and unaffordable loans tells us that many qualified homeowners are being unnecessarily turned away from HAMP, those receiving loan modifications often obtain terms quite different from HAMP, and even the HAMP-compliant modifications are limited in what they can do for homeowners with high loan principals.

We anticipate that the data will reflect the experience of hundreds of homeowners and their advocates, showing that the program is too narrow and too hard to implement. When the data substantiates our necessarily impressionistic description of the failures of HAMP, Congress should enact legislation to mandate loan modifications where they are more profitable to investors than foreclosure. Loss mitigation, in general, should be preferred over foreclosure. Additionally, Congress should revisit the question of bankruptcy relief. First-lien home loans are the only loans that a bankruptcy judge cannot modify.⁷⁸ The failure to allow bankruptcy judges to align the value of the debt with the value of the collateral contributes to our ongoing foreclosure crisis.

Basic problems in the structure of the servicing industry need to be addressed in order for the homeowner-servicer relationship to be functional. From the homeowner's perspective, one of the biggest obstacles to loan modification is finding a live person who can provide reliable information

⁷⁸ Second liens can be modified if they are, as many are in the current market, completely unsecured because the amount of the first lien equals or exceeds the market value of the property.

about the loan account and who has authority to make loan modification decisions. Federal law should require that mortgage servicers provide homeowners with contact information for a real person with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan. While the Real Estate Settlement Procedures Act currently requires servicers to respond to homeowners' request for information and disputes within 60 days, in practice many such inquires go unanswered. Despite this failure to respond, servicers are still permitted to proceed to collection activities, including foreclosure. Essential changes to this law governing servicers should ensure that homeowners facing foreclosure would no longer be at the mercy of their servicer. There should be transparency in the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history. Servicers should be prohibited from initiating or continuing a foreclosure proceeding during the period in which an outstanding request for information or a dispute is pending.

Further reform of the tax code to simplify the exclusion of discharge of indebtedness income would also be of assistance to many homeowners, particularly homeowners with significant refinancing debt whose servicers are persuaded to do sustainable principal reductions.⁷⁹

VI. Conclusion

Thank you for the opportunity to testify before the Committee today. The foreclosure crisis is continuing to swell. We are drowning in the detritus of the lending boom of the last decade. The need to act is great. The HAMP program must be strengthened. Homeowners who qualify must have the right to be offered a sustainable loan modification prior to foreclosure. Passage of legislation to allow for loan modifications in bankruptcy, to reform the servicing industry, and to

⁷⁹ See generally 2008 Nat'l. Taxpayer Advocate Ann. Rep. at vi – vii (summarizing recommendations regarding changes to the treatment and reporting of cancellation of debt income in the mortgage context).

address the tax consequences of loan modifications also would aid in protecting homeowners from indifferent and predatory servicing practices and reducing the foreclosure surge. Together, these measures would save many homes and stabilize the market. We look forward to working with you to address the economic challenges that face our nation today.

Attachment A—Ocwen Loan Modification Agreement



PAYMENT REMITTANCE INFORMATION

PLEASE DON'T FORGET TO:

1. Make checks payable to Ocwen Loan Servicing, LLC.
2. Always include your loan number with your payment.
3. The down payment must be in the form of certified funds.

OVERNIGHT DELIVERY

(Money Order & Certified Checks Only)

OCWEN LOAN SERVICING, LLC
ATTN: CASHIERING DEPARTMENT
12650 INGENUITY DRIVE
ORLANDO, FL 32826

MONEY GRAM

RECEIVER CODE: 3237
PAYABLE TO: OCWEN LOAN SERVICING, LLC
CITY: ORLANDO
STATE: FLORIDA
REFERENCE: [REDACTED]
AGENT LOCATER: (800) 926-9400

BANK WIRE

BANK: JPMorgan Chase Bank, NA
ABA: 021000021
ACCOUNT NAME: Ocwen Financial Corporation
ACCOUNT NUMBER: 00113339999
REFERENCE: Loan Number, Property Address,
and Borrower Name
Email: Transferfunds@ocwen.com with the details
of the wire.

BY WUQC

Code City: Ocwen
State: FL
Reference: Loan # [REDACTED]
Attn: Home Retention Department,
Home Retention Consultant

LOAN MODIFICATION AGREEMENT

Ocwen Loan Servicing, LLC ("Ocwen") is offering you this Loan Modification Agreement ("Agreement"), dated June 1, 2009, which modifies the terms of your home loan obligations as described in detail below:

- A. the Mortgage, Deed of Trust, or Security Deed (the "Mortgage"), dated and recorded in the public records of CLAY County, and
- B. the Note, of the same date and secured by the Mortgage, which covers the real and personal property described in the Mortgage and defined therein as the "Property", located at [REDACTED]

Pursuant to our mutual agreement to modify your Note and Mortgage and in consideration of the promises, conditions, and terms set forth below, the parties agree as follows:

1. You agree that the new principal balance due under your modified Note and the Mortgage will be \$125,056.60. Upon modification, your Note will become contractually current; however, fees and charges that were not included in this principal balance will be your responsibility.
2. You promise to make an initial down payment in the amount of \$1,281.00 on or before June 12, 2009, after which you will commence payments of principal and interest in the amount of \$555.87 beginning on July 1, 2009 and continuing on the same day of each succeeding month for a five (5) year period. At the end of this period, your payment is subject to change based on paragraph 4 below.
3. Any payments due for taxes and insurance will be your responsibility in addition to the payments of principal and interest required under the terms of this modification. If this loan is currently escrowed, Ocwen will continue to collect the escrow amounts with your monthly principal and interest payment.
4. Upon Modification, the annual rate of interest charged on the unpaid principal balance of your loan will be 4.42100%. This rate will remain in effect until the end of a five (5) year period beginning with your first payment after the down payment. At the end of this period, your interest rate will be calculated according to the terms of your original loan documentation.



5. You promise to make payments of principal and interest on the same day of each succeeding month until May 1, 2036, at which time a final balloon payment in an amount equal to all remaining amounts under the Note and Modification will be due.
6. You will comply with all other covenants, agreements, and requirements of your Mortgage, including without limitation, the covenants and agreements to make all payments of taxes, insurance premiums, assessments, escrow items, impounds, and all other payments that you are obligated to make under the Mortgage, except as otherwise provided herein.
7. If you sell your property, refinance, or otherwise payoff your loan during the 12 months following the date of Modification, the Modification will be voidable at the sole option of Ocwen and all amounts owed under the obligations existing prior to the Modification will be due and owing.
8. You understand and agree that:
 - (a) All the rights and remedies, stipulations, and conditions contained in your Mortgage relating to default in the making of payments under the Mortgage will also apply to default in the making of the modified payments hereunder.
 - (b) All covenants, agreements, stipulations, and conditions in your Note and Mortgage will remain in full force and effect, except as herein modified, and none of the your obligations or liabilities under your Note and Mortgage will be diminished or released by any provisions hereof, nor will this Agreement in any way impair, diminish, or affect any of Ocwen's rights under or remedies on your Note and Mortgage, whether such rights or remedies arise there under or by operation of law. Also, all rights of recourse to which Ocwen is presently entitled against any property or any other persons in any way obligated for, or liable on, your Note and Mortgage are expressly reserved by Ocwen.
 - (c) Any expenses incurred in connection with the servicing of your loan, but not yet charged to your account as of the date of this Agreement, may be charged to your account after the date of this Agreement.
 - (d) You have no right of set-off or counterclaim, or any defense to the obligations of your Note or Mortgage.
 - (e) Nothing in this Agreement will be understood or construed to be a satisfaction or release in whole or in part of your Note and Mortgage.
 - (f) You agree to make and execute such other documents or papers as may be necessary or required to effectuate the terms and conditions of this Agreement which, if approved and accepted by Ocwen, will bind and inure to your heirs, executors, administrators, and assigns.
 - (g) You understand that this agreement is legally binding and that it affects your rights. You confirm that you have had the opportunity to obtain, independent legal counsel concerning this Agreement and are signing this Agreement voluntarily and with full understanding of its contents and meaning.
 - (h) Corrections and Omissions. You agree to execute such other and further documents as may be reasonably necessary to consummate the transactions contemplated herein or to perfect the liens and security interests intended to secure the payment of the loan evidenced by the Note.
9. BY EXECUTING THIS MODIFICATION, YOU FOREVER IRREVOCABLY WAIVE AND RELINQUISH ANY CLAIMS, ACTIONS OR CAUSES OF ACTION, STATUTE OF LIMITATIONS OR OTHER DEFENSES, COUNTERCLAIMS OR SETOFFS OF ANY KIND WHICH EXIST AS OF THE DATE OF THIS MODIFICATION, WHETHER KNOWN OR UNKNOWN, WHICH YOU MAY NOW OR HEREAFTER ASSERT IN CONNECTION WITH THE MAKING, CLOSING, ADMINISTRATION, COLLECTION OR THE ENFORCEMENT BY OCWEN OF THE LOAN DOCUMENTS, THIS MODIFICATION OR ANY OTHER RELATED AGREEMENTS.
10. BY EXECUTING THIS MODIFICATION, YOU IRREVOCABLY WAIVE ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS MODIFICATION AND ANY RELATED AGREEMENTS OR DOCUMENTS OR TRANSACTIONS CONTEMPLATED IN THIS MODIFICATION.



Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

Ocwen Loan Servicing, LLC

Borrower: [REDACTED]

By: _____

6348635

This communication is from a debt collector attempting to collect a debt; any information obtained will be used for that purpose. However, if the debt is in active bankruptcy or has been discharged through bankruptcy, this communication is not intended as and does not constitute an attempt to collect a debt.



June 3, 2009

Loan Number: [REDACTED]

Property Address: [REDACTED]

PROPOSED MODIFICATION AGREEMENT

Dear Borrower(s):

Enclosed please find a proposed modification agreement (the "Agreement") on your loan referenced above for your review and consideration.

In order to accept this modification on your loan, you must complete ALL of the following steps on or before June 12, 2009, ("Due Date"):

- 1. **SIGN** the bottom of the Agreement on the line(s) for the Borrower(s);
- 2. **FAX** the fully executed Agreement to: Attention: Home Retention Department
(407) 737-5693
- 3. **PAY** the full down payment in the amount of: \$287.00
[See Payment Instructions Attached]
- 4. **NEW MONTHLY PAYMENT:** \$94.12 (which may or may not include escrow)
starting on July 1, 2009.
- 5. **SEND** proof of insurance coverage* Attention: Escrow Department
(Send proof of insurance ONLY to Escrow Fax: 1-888-882-1816
Dept. DO NOT include the Agreement.) E-mail: dateinsuranceinfo@ocwen.com

* Proof of insurance and the Agreement must be sent separately to the correct departments using the fax numbers provided above. Failure to send proof of insurance coverage before the Due Date will constitute acceptance of a force placed policy and agreement to pay the costs of such force placed policy, so long as all other items are complete.

Time is of the essence on this offer. If ALL of the items above are not completed by the Due Date, the Agreement shall have no force or effect and any down payment received will be returned to you. Please be advised that Ocwen Loan Servicing, LLC will not delay, postpone or otherwise stop any collection efforts until ALL of the steps above have been completed.

If you have any questions or require additional information, please contact the Home Retention Department directly at (877) 596-8580.

Sincerely,

Ocwen Loan Servicing, LLC

6348643



PAYMENT REMITTANCE INFORMATION

PLEASE DON'T FORGET TO:

1. Make checks payable to Ocwen Loan Servicing, LLC.
2. Always include your loan number with your payment.
3. The down payment must be in the form of certified funds.

OVERNIGHT DELIVERY

(Money Order & Certified Checks Only)

OCWEN LOAN SERVICING, LLC
ATTN: CASHIERING DEPARTMENT
12650 INGENUITY DRIVE
ORLANDO, FL 32826

MONEY GRAM

RECEIVER CODE: 3237
PAYABLE TO: OCWEN LOAN SERVICING, LLC
CITY: ORLANDO
STATE: FLORIDA
REFERENCE: [REDACTED]
AGENT LOCATER: (800) 926-9400

BANK WIRE

BANK: JPMorgan Chase Bank, NA
ABA: 021000021
ACCOUNT NAME: Ocwen Financial Corporation
ACCOUNT NUMBER: 00113339999
REFERENCE: Loan Number, Property Address,
and Borrower Name
Email: Transferfunds@ocwen.com with the details
of the wire.

BY WUOC

Code City: Ocwen
State: FL
Reference: Loan [REDACTED]
Attn: Home Retention Department,
Home Retention Consultant

LOAN MODIFICATION AGREEMENT

Ocwen Loan Servicing, LLC ("Ocwen") is offering you this Loan Modification Agreement ("Agreement"), dated June 3, 2009, which modifies the terms of your home loan obligations as described in detail below:

- A. the Mortgage, Deed of Trust, or Security Deed (the "Mortgage"), dated and recorded in the public records of CLAY County, and
- B. the Note, of the same date and secured by the Mortgage, which covers the real and personal property described in the Mortgage and defined therein as the "Property", located at [REDACTED]

Pursuant to our mutual agreement to modify your Note and Mortgage and in consideration of the promises, conditions, and terms set forth below, the parties agree as follows:

1. You agree that the new principal balance due under your modified Note and the Mortgage will be \$31,082.01. Upon modification, your Note will become contractually current; however, fees and charges that were not included in this principal balance will be your responsibility.
2. You promise to make an initial down payment in the amount of \$287.00 on or before June 12, 2009, after which you will commence payments of principal and interest in the amount of \$94.12 beginning on July 1, 2009 and continuing on the same day of each succeeding month for a five (5) year period. At the end of this period, your payment is subject to change based on paragraph 4 below.
3. Any payments due for taxes and insurance will be your responsibility in addition to the payments of principal and interest required under the terms of this modification. If this loan is currently escrowed, Ocwen will continue to collect the escrow amounts with your monthly principal and interest payment.
4. Upon Modification, the annual rate of interest charged on the unpaid principal balance of your loan will be 2.00000%. This rate will remain in effect until the end of a five (5) year period beginning with your first payment after the down payment. At the end of this period, your interest rate will be calculated according to the terms of your original loan documentation.



5. You promise to make payments of principal and interest on the same day of each succeeding month until May 1, 2021, at which time a final balloon payment in an amount equal to all remaining amounts under the Note and Modification will be due.
6. You will comply with all other covenants, agreements, and requirements of your Mortgage, including without limitation, the covenants and agreements to make all payments of taxes, insurance premiums, assessments, escrow items, impounds, and all other payments that you are obligated to make under the Mortgage, except as otherwise provided herein.
7. If you sell your property, refinance, or otherwise payoff your loan during the 12 months following the date of Modification, the Modification will be voidable at the sole option of Ocwen and all amounts owed under the obligations existing prior to the Modification will be due and owing.
8. You understand and agree that:
 - (a) All the rights and remedies, stipulations, and conditions contained in your Mortgage relating to default in the making of payments under the Mortgage will also apply to default in the making of the modified payments hereunder.
 - (b) All covenants, agreements, stipulations, and conditions in your Note and Mortgage will remain in full force and effect, except as herein modified, and none of the your obligations or liabilities under your Note and Mortgage will be diminished or released by any provisions hereof, nor will this Agreement in any way impair, diminish, or affect any of Ocwen's rights under or remedies on your Note and Mortgage, whether such rights or remedies arise there under or by operation of law. Also, all rights of recourse to which Ocwen is presently entitled against any property or any other persons in any way obligated for, or liable on, your Note and Mortgage are expressly reserved by Ocwen.
 - (c) Any expenses incurred in connection with the servicing of your loan, but not yet charged to your account as of the date of this Agreement, may be charged to your account after the date of this Agreement.
 - (d) You have no right of set-off or counterclaim, or any defense to the obligations of your Note or Mortgage.
 - (e) Nothing in this Agreement will be understood or construed to be a satisfaction or release in whole or in part of your Note and Mortgage.
 - (f) You agree to make and execute such other documents or papers as may be necessary or required to effectuate the terms and conditions of this Agreement which, if approved and accepted by Ocwen, will bind and inure to your heirs, executors, administrators, and assigns.
 - (g) You understand that this agreement is legally binding and that it affects your rights. You confirm that you have had the opportunity to obtain, independent legal counsel concerning this Agreement and are signing this Agreement voluntarily and with full understanding of its contents and meaning.
 - (h) Corrections and Omissions. You agree to execute such other and further documents as may be reasonably necessary to consummate the transactions contemplated herein or to perfect the liens and security interests intended to secure the payment of the loan evidenced by the Note.
9. BY EXECUTING THIS MODIFICATION, YOU FOREVER IRREVOCABLY WAIVE AND RELINQUISH ANY CLAIMS, ACTIONS OR CAUSES OF ACTION, STATUTE OF LIMITATIONS OR OTHER DEFENSES, COUNTERCLAIMS OR SETOFFS OF ANY KIND WHICH EXIST AS OF THE DATE OF THIS MODIFICATION, WHETHER KNOWN OR UNKNOWN, WHICH YOU MAY NOW OR HEREAFTER ASSERT IN CONNECTION WITH THE MAKING, CLOSING, ADMINISTRATION, COLLECTION OR THE ENFORCEMENT BY OCWEN OF THE LOAN DOCUMENTS, THIS MODIFICATION OR ANY OTHER RELATED AGREEMENTS.
10. BY EXECUTING THIS MODIFICATION, YOU IRREVOCABLY WAIVE ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS MODIFICATION AND ANY RELATED AGREEMENTS OR DOCUMENTS OR TRANSACTIONS CONTEMPLATED IN THIS MODIFICATION.



Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

Ocwen Loan Servicing, LLC

Borrower: [REDACTED]

By: _____

6348643

This communication is from a debt collector attempting to collect a debt; any information obtained will be used for that purpose. However, if the debt is in active bankruptcy or has been discharged through bankruptcy, this communication is not intended as and does not constitute an attempt to collect a debt.

Attachment B—Aurora Loan Services Letter and Workout Agreement

FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:25PM P3

 **Aurora - Loan Services**2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [REDACTED]

Page 2 of 2

Please mail all correspondence, requested information and the executed agreement to our Servicing Center at:

Overnight Delivery ServicesAurora Loan Services
Attn: Home Retention
2617 College Park
Scottsbluff, NE 69361

or

U.S. Postal Delivery ServicesAurora Loan Services
Attn: Home Retention
P.O. Box 1706
Scottsbluff, NE 69363-1706

Notwithstanding anything to the contrary contained in the Special Forbearance Agreement, the parties hereto acknowledge the effect of a discharge in bankruptcy that may have been granted to the Borrower(s) prior to the execution hereof and that the Lender may not pursue the Borrower(s) for personal liability. However, the parties acknowledge that the Lender retains certain rights, including but not limited to the right to foreclose its lien under appropriate circumstances. The parties agree that the consideration for this Agreement is Aurora Loan Services' forbearance from presently exercising its rights and pursuing its remedies under the Security Instrument as a result of the Borrower's default of its obligations there under. Nothing herein shall be construed to be an attempt to collect against the Borrower(s) personally or an attempt to revive personal liability.

Signing the attached documents in no way affects or eliminates any rights you have been given in this letter or any correspondence attached hereto.

If you have any questions, please contact one of our Home Retention Counselors at the address above or by calling 800-550-0509.

Sincerely,

Home Retention Group
Aurora Loan Services

Enclosure

Aurora Loan Services is a debt collector. Aurora Loan Services is attempting to collect a debt and any information obtained will be used for that purpose. However, if you are in bankruptcy or received a bankruptcy discharge of this debt, this communication is not an attempt to collect the debt against you personally, but is notice of a possible enforcement of the lien against the collateral property.



FROM :PROJEKT GROUP

FAX NO. :561-272-6295

May. 23 2009 10:25PM P4

Aurora • Loan Services

2617 COLLEGE PARK - P.O. BOX 1706 - SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

WORKOUT AGREEMENT

BY AND BETWEEN AURORA LOAN SERVICES

AND

~~XXXXXXXXXXXXXXXXXXXX~~
~~XXXXXXXXXXXXXXXXXXXX~~

Property Address: ~~XXXXXXXXXXXXXXXXXXXX~~
~~XXXXXXXXXXXXXXXXXXXX~~

Loan No. ~~XXXXXXXXXXXX~~

This Workout Agreement is made May 20, 2009, by and between AURORA LOAN SERVICES ("Lender") located at 2617 College Park, Scottsbluff, NE 69361, and ~~XXXXXXXXXXXXXXXXXXXX~~ (individually and collectively, "Customer").

WHEREAS, Lender is the servicing agent and/or the owner and holder of a certain Note dated 06-14-06, executed and delivered by Customer, in the original principal amount of \$ 256,000 (the "Note"). The Note is secured by a mortgage, deed of trust or comparable security instrument dated 06-14-06, (the "Security Instrument"), on the property located at the address specified above (the "Property"). The Note and Security Instrument are collectively referred to as the "Loan Documents".

WHEREAS, Customer is in default under the Loan Documents, has failed to make payment of monthly installments of principal, interest, and escrow, if any, and has incurred additional expenses authorized under the Loan Documents, resulting in a total arrearage now due of \$ 30,515.07, as more particularly set forth below:

Unpaid monthly payment(s) of PITI* from 07-01-08 through and including 05-20-09	\$ 25,906.65
Accrued Late Charges	689.92
NSF Charges	.00
Legal Fees	1,808.00
Corporate Advances**	2,110.50
Other Fees***	.00
Minus Credit (suspense balance/partial payment)	<u>.00</u>
Total Amount Due (the "Arrearage")	\$ 30,515.07

* "PITI" means the monthly payment of principal, interest, and escrows, required, for taxes and insurance premium installments.
 ** "Corporate Advances" include, but are not limited to, property inspection fees, property preservation fees, legal fees, foreclosure fees and costs, appraisal fees, BPO (i.e. broker price opinion) fees, title report fees, recording fees, and subordination fees.
 *** "Other Fees" include, but are not limited to, short payment advances and Speed ACH fees.



FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:26PM P5

 **Aurora • Loan Services**2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [REDACTED]

Page 2 of 5

WHEREAS, as a result of Customer's default, Lender (i) has the right to accelerate, and to require Customer to make immediate payment in full, all of the sums owed under the Note and secured by the Security Instrument, (ii) has so accelerated and declared due in full all such sums, and (iii) may have already commenced foreclosure proceedings to sell the Property.

WHEREAS, as of the date of execution of the Agreement, Lender commenced Foreclosure proceedings to sell the property on 10/29/08 by legal filing in the county and state where the Property is located. A Foreclosure sale has not yet been scheduled.

WHEREAS, customer has requested Lender's forbearance in exercising its rights and remedies under the default provisions of the Loan Documents and with regard to any foreclosure action that may now be pending.

WHEREAS, Customer has requested and Lender has agreed to allow Customer to repay the Arrearage pursuant to a loan work-out arrangement on the terms set forth herein.

NOW, THEREFORE, in consideration of the promises and mutual covenants herein contained, the parties hereto agree as follows:

1. Term. This Agreement shall expire on the "Expiration Date," as defined in Attachment A.
2. Lenders Forbearance. Lender shall forbear from exercising any or all of its rights and remedies now existing or arising during the term of this Agreement under the Loan Documents, provided there is no "Default", as such term is defined in paragraph 5.
3. Customer's Admissions. Customer admits that the Arrearage is correct and is currently owing under the Loan Documents, and represents, agrees and acknowledges that there are no defenses, offsets, or counterclaims of any nature whatsoever to any of the Loan Documents or any of the debt evidenced or secured thereby.

Customer admits and agrees that any and all postponements of a foreclosure sale, made during the term of this Agreement or in anticipation of this Agreement, are done by mutual consent of the Customer and Lender and that, to the extent allowed by applicable law, any such foreclosure sale may be postponed from time to time until the loan evidenced by the Note is fully reinstated or the foreclosure sale is consummated. Lender shall be under no obligation to dismiss a pending foreclosure proceeding until such time as all terms and conditions of this Agreement and Attachment A have been fully performed.

4. Terms of Workout. See Attachment A, which is made a part hereof.



FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:26PM P6

 **Aurora • Loan Services**2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648Loan No. **60[REDACTED]**

Page 3 of 5

5. Default. If Customer fails to make any of the payments specified in Attachment A on the due dates and in the amount stated, or otherwise fails to comply with any of the terms and conditions herein or therein (any such even hereby defined as a "Default"), Lender, at its sole option, may terminate this Agreement without further notice to Customer. In such case, all amounts that are then owing under the Note, the Security Instrument, and this Agreement shall become immediately due and payable, and Lender shall be permitted to exercise any and all rights and remedies provided for in the Loan Documents, including, but not limited to, immediate commencement of a foreclosure action or resumption of a pending foreclosure action without further notice to Customer.

6. No Waiver. Nothing contained herein shall constitute a waiver of any of all of the Lender's rights or remedies, including the right to commence or resume foreclosure proceedings. Failure by Lender to exercise any right or remedy under this Agreement or as otherwise provided by applicable law shall not be deemed to be a waiver thereof.

7. Status of Default and Foreclosure. Customer acknowledges that if the Lender previously notified the Customer that the account was in default, that the Note and Security Instrument are accelerated and the debt evidenced by the Note is due in full, the account remains in default, such Loan Documents remain accelerated, and such debt due in full, although Customer may be entitled by law to cure such default by bringing the loan evidenced by Note current rather than paying it in full. Lender's acceptance of any payments from Customer which, individually, are less than the total amount due to cure the default described herein shall in no way prevent Lender from continuing with collection action, or require Lender to re-notify Customer of such default, re-accelerate the loan, re-issue any notice, or resume any process prior to Lender proceeding with collection action if Customer defaults. Customer agrees that a foreclosure action if commenced by the Lender against Customer will not be withdrawn unless Lender determines to do so by applicable law. In the event Customer Defaults, the foreclosure will commence, or resume from the point at which it was placed on hold, without further notice.

8. Limited Modification. Except as otherwise provided in this Agreement, the Note and Security Instrument, and any amendments thereto, are ratified and confirmed and shall remain in full force and effect.

1 A typical example of this would be if Lender decides to accept a partial or untimely payment from Customer instead of returning such payment or terminating this Agreement as provided herein, Lender shall not be precluded from rejecting a subsequent partial or untimely payment, terminating this Agreement, or taking any other action permitted by applicable law.



FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:27PM P7

 **Aurora - Loan Services**2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [REDACTED]

Page 4 of 5

9. Application of Payments. The payments received by Lender from Customer pursuant to this Agreement shall be applied, at Lender's sole option, first to the earliest monthly payment under the Note that is due. Any amounts received by Lender that are less than the full payment under then due and owing under this Agreement shall be, at Lender's sole option, (1) returned to Customer, or (2) held by Lender in partial or suspense payment balance until sufficient sum is received by Lender to apply a full payment. If this Agreement is canceled and/or terminated for any reason, any remaining funds in this partial or suspense payment balance shall be credited towards Customer's remaining obligation owing in connection with the loan and shall not be refunded.
10. Methods of Making Payments. All payments made to Lender under this Agreement shall (i) contain the Lender's loan number shown above, (ii) unless otherwise agreed to by the Lender, be payable in certified funds by means of cashier's check, Western Union (code city: Bluff, NE) money order, or certified check, and (iii) be sent to AURORA LOAN SERVICES as specified in Attachment A. Any payment made other than strictly pursuant to the requirements of this paragraph 10 and Attachment A shall not be considered to have been received by Lender, although Lender may, in its sole discretion, decide to accept any non-conforming payment.
11. Credit Reporting. The payment status of Customer's loan in existence immediately prior to execution of this Agreement will be reported monthly to all credit reporting agencies for the duration of this Agreement and thereafter. Accordingly, Lender will report the loan subject to this Agreement as delinquent if the loan is not paid current under the Loan Documents, even if Customer makes timely payments to Lender under this Agreement. However, Lender may disclose that Customer is in a repayment or work-out plan. This Agreement does not constitute an agreement by Lender to waive any reporting of the delinquency status of loan payments.
12. Property Taxes, Insurance, and Other Amounts. If Customer's loan is not escrowed for taxes and insurance premium payments, it is Customer's responsibility to pay all property taxes, premiums for insurance, and all other amounts Customer agreed to pay as required under the terms of the Loan Documents. Customer's failure to pay property taxes, amounts owed on any senior lien security instrument, other amounts that may attain priority over the Security Instrument, or insurance premiums, in each case before their due date, shall constitute a Default hereunder.
13. The Entire Agreement. This Agreement sets forth all of the promises, covenants, agreements, conditions and understandings between the parties hereto with respect to the subject matter hereof. This Agreement supersedes all prior understandings, inducements or conditions, express or implied, oral or written, with respect thereto except as contained or referred to herein. This Agreement may not be amended, waived, discharged or terminated orally but only by an instrument in writing.



FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:28PM PB

Aurora - Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [REDACTED]

Page 5 of 5

14. Time is of the Essence. The Customer agrees and understands that TIME IS OF THE ESSENCE as to all of the Customer's obligations under this Agreement. The grace period for monthly payments under the Loan Documents will not apply to payment under this Agreement. Therefore, the Lender must receive the payments under this Agreement on or before the Due Dates specified in Attachment A.

15. Assignment by Customer Prohibited. This Agreement shall be non-transferable by Customer. However, if the legal or beneficial interest or the servicing of this loan is transferred by Lender, this Agreement inures to the benefit of any subsequent servicer or beneficial interest holder of the Note.

16. Severability. To the extent that any word, phrase, clause, or sentence of this Agreement shall be found to be illegal or unenforceable for any reason, such word, phrase, clause, or sentence shall be modified or deleted in such a manner so as to make the Agreement, as modified, legal and enforceable under applicable law, and the balance of the Agreement or parts thereof shall not be affected thereby, the balance being construed as severable and independent; provided that no such severability shall be effective if it materially changes the economic benefit of this Agreement to either party.

17. Execution in Counterparts. This Agreement may be executed and delivered in two or more counterparts, each of which, when so executed and delivered, shall be an original, but such counterparts shall together constitute but one and the same instrument and Agreement. Facsimile signatures shall be deemed as valid as originals.

18. Customer Contact. If Customer has any questions regarding this matter, Customer should contact one of Lender's Loan Counselors at the address above or by calling 800-550-0509.

IN WITNESS HEREOF, the parties hereto have caused this Agreement to be duly executed as of the date signed.

Dated: _____
[REDACTED] Borrower

Dated: _____
[REDACTED] Borrower

Aurora Loan Services
Dated: _____

Aurora Loan Services is a debt collector. Aurora is attempting to collect a debt and any information obtained will be used for that purpose. However, if you are in bankruptcy or received a bankruptcy discharge of this debt, this communication is not an attempt to collect the debt against you personally, but is notice of a possible enforcement of the lien against the collateral property.



FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:28PM P9


Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
 PHONE: 800-550-0508 • FAX: 303-728-7648

ATTACHMENT A-STIPULATED PAYMENTS

- a.1 For purposes of repayment of the Arrearage, Customer shall pay \$870.41, on or before 06/01/2009. Thereafter, Customer shall pay three (3) stipulated monthly payments each in the amount of \$870.41 (each, a "Plan payment"). On or before 06/01/2009 (the "Agreement Return Date"), Customer shall execute and return the Agreement, including this Attachment A, in accordance with the following instructions:

<u>If by overnight mail service to</u>	<u>or if by US Postal Services to</u>
Aurora Loan Services	Aurora Loan Services
Attention: Home Retention	Attention: Home Retention
2617 College Park	P.O. Box 1706
Scottsbluff, NE 69361	Scottsbluff, NE 69363-1706

The Agreement will be of no force and effect unless Lender receives the executed Agreement, including Attachment A, as well as the first Plan payment by the Agreement Return Date. Customer shall remit to Lender the first Plan payment, in the amount specified above, made payable to Aurora Loan Services in certified funds by means of cashier's check, money order, Western Union (code city: Bluff, NE), or certified check. All Plan payments, including the first Plan payment, shall contain the Lender's loan number shown in the Agreement and, unless otherwise agreed to by the Lender, shall be payable in certified funds as described above and to be sent to Lender's Payment Processing Center in accordance with the following instructions:

<u>If by overnight mail service to</u>	<u>or if by US Postal Services to</u>
Aurora Loan Services	Aurora Loan Services
Attention: Cashiering Department	Attention: Cashiering Department
10350 Park Meadows Drive	P.O. Box 5180
Littleton, CO 80124	Denver, CO 80217-5180

- a.2 Plan payments are to be paid on or before the 1st day of every month (each, a "Due Date"). Lender must receive each Plan payment by the Due Date of each month. The Agreement shall expire on the Due Date of the last Plan payment contemplated by section a.1 above (the "Expiration Date"). At the time Customer makes the third (3rd) Plan payment under this Agreement, it shall be the Customer's responsibility to provide Aurora with accurate and complete financial information in support of the Customer's request for a loan modification or other workout option. Customer must also provide Lender with a completed Borrower's Financial Statement and proof of income (copies of Customer's two (2) most recent pay stubs) to enable Lender to properly evaluate Customer's current financial situation and the Customer's request for a loan modification or other loan workout option. Tender of the last Plan payment shall not be deemed acceptance by Aurora of a workout plan or loan modification.



FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:29PM P10

Aurora - Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. ~~XXXXXXXXXX~~

- b. The aggregate Plan payment will be insufficient to pay the Arrearage. At the Expiration Date, a portion of the Arrearage will still be outstanding. Because payment of the Plan payments will not cure the Arrearage, Customer's account will remain delinquent. Upon the Expiration Date, Customer must cure the Arrearage through a full reinstatement, payment in full, loan modification agreement or other loan workout option that Lender may offer (individually and collectively, a "Cure Method.") Customer's failure to enter into a Cure Method will result in the loan being disqualified from any future Lender Home Retention Group program with respect to the loan evidenced by the Note, and regular collection activity will continue, including, but not limited to, commencement or resumption of the foreclosure process, as specified in paragraphs 5 and 7 of the Agreement.

IN WITNESS HEREOF, the parties hereto have caused this Attachment A to be duly executed as of the date signed below.

Dated: _____
~~XXXXXXXXXX~~ Borrower

Dated: _____
~~XXXXXXXXXX~~ Borrower

Aurora Loan Services

Dated: _____ By: _____

Title: _____

FROM : PROJEKT GROUP

FAX NO. : 561-272-6295

May. 23 2009 10:29PM P11

Aurora - Loan Services

May 20, 2009

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

3640038261699534LM02905-20-09

RE: Loan No. [REDACTED]
Borrower(s): [REDACTED]
Property Address: [REDACTED] 45

ITEMIZATION OF FEES, COSTS AND OTHER CHARGES

Dear Customer(s):

This Addendum supplements the Attached Letter.

Below is a detailed itemization of the unpaid fees, costs and other charges due on the above-referenced loan.

<u>Description</u>	<u>Unpaid Balance</u>
Foreclosure Fees	\$1,609.50
Post Liquidation Transaction	\$96.00
Property Value Fee	\$405.00



Attachment C—Chase Waiver of HAMP Rights

**JPMorgan Chase Bank, National Association,
successor interest to Washington Mutual Bank**

("Lender")

has offered to try to qualify you for a modification (an "MHA Modification") under the Making Home Affordable Plan announced by the Obama Administration on March 4, 2009. You have declined to be considered for an MHA Modification, opting instead to go forward with the modification offer made by Lender to you prior to the March 4, 2009 announcement (the "Prior Modification").

Had you qualified for an MHA Modification, you may have been entitled to the following:

- A reduction in monthly payment to no more than 31% of documented and verified gross monthly income (DTI).
- A modification sequence requiring the Lender to first reduce the interest rate (subject to a rate floor of 2%), then if necessary extend the term or amortization of the loan up to a maximum of 40 years, and then if necessary forbearing principal to get to the 31% DTI.
- Up to \$1,000 of principal reduction payments on your mortgage each year for up to five years for making your payments on time each year.

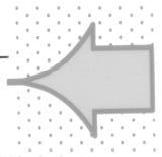
By signing below, you acknowledge that (i) you have been advised of and understand the above features of an MHA Modification, (ii) you understand and agree that Lender is not obligated to match such features in the Prior Modification, (iii) you have voluntarily declined consideration for an MHA Modification, and (iv) you have agreed to hold Lender, its successors and assigns, harmless as a result of your decision to decline consideration for an MHA Modification and enter into the Prior Modification.

Borrower Name

Date

Borrower Name

Date



Borrower Name

Date

Attachment D—WaMu HAMP Trial Plan Agreement provision requiring waiver of loan modification upon subsequent bankruptcy filing.



Washington Mutual
7255 Baymeadows Way
Jacksonville, FL 32256

TRIAL PLAN AGREEMENT

- * Your loan is now due for the months of 06/09 to 06/09.
- * You must send \$0.00 to reduce your total delinquency.
- * We must receive the initial payment of \$922.37 along with your signed Trial Plan Agreement ("Agreement") by 07/01/09. After that, the payment schedule outlined below must be followed. If you do not make your payments on time, or if any of your payments are returned for non-sufficient funds, this Agreement will be in breach and collection and/or foreclosure activity will resume.

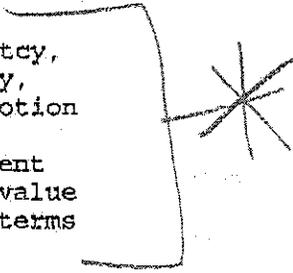
Your payments must be received in our office on or before the following dates:

\$922.37	08/01/09
\$922.37	09/01/09

Payments are subject to change due to escrow analysis and or interest rate changes, if applicable. If you are notified of a payment adjustment, please contact our office immediately so we can adjust the terms of your Agreement accordingly. If all payments are made as scheduled, we will reevaluate your application for assistance and determine if we are able to offer you a permanent workout solution to bring your loan current.

All of the original terms of your loan remain in full force and effect, unless specifically mentioned within this Agreement. If any part of this Agreement is breached, Washington Mutual has the option to terminate the Agreement and begin or resume foreclosure proceedings pursuant to your loan documents and applicable law.

You acknowledge that in the event you file a petition in bankruptcy, Washington Mutual may elect to take any and all actions necessary, including, but not limited to voiding this Agreement, filing a Motion for relief from the automatic stay or a Motion to dismiss or any permitted state law remedies, which in Washington Mutual's judgment are reasonably necessary to secure or protect our security, the value of the security and/or to enforce our rights under the original terms of your loan.



I/We agree to the above Agreement and will make payments as outlined above. I/We understand that foreclosure action can be taken if the terms of this Agreement are not met.

Date LA-LM036-004-B9E.5797.071006

Attachment E—Comment of Professor Alan M. White

Comment on Adelino, Girardi and Willen
Alan M. White, Valparaiso University School of Law

In their recent paper, Adelino, Girardi and Willen argue that mortgage servicers have acted reasonably in not modifying significant numbers of defaulted mortgages, but instead in going ahead with foreclosures. They report on some empirical findings from their data, and then also posit a purely theoretical model which might, they argue, justify servicer inaction.

The empirical data demonstrate that servicers were not significantly more likely to modify mortgages held in portfolio than mortgages held in securitized pools. While this finding tends to rule out some possible explanations for inadequate levels of modifications, it does not in itself demonstrate that servicers pursued the optimal modification and foreclosure strategies.

The theoretical portion of the paper points out the significance of two factors that servicers must consider in deciding whether to modify mortgages. First, if many defaulted mortgage borrowers are able to bring their loans current or pay them in full (cure the default) then offering those borrowers a modification that reduces the value of the loan to investors results in losses. Second, modifications that are not successful, because the homeowner eventually defaults in making modified payments, can increase losses.

While the theoretical point is correct, current, actual experienced cure and redefault rates do not justify servicers' failure to modify mortgages. For example, if a servicer assumes that 30% of the loans being considered for modification will cure, and that 40% of the loans modified will redefault, and if we also assume that loss severities on foreclosure sales are greater than 60%, as they are today, then modification produces a net benefit for investors so long as the modified loan's present value is at least 80% of the unmodified loan value. Few, if any modifications currently being made reduce the present value of the mortgage payments by 20%. Much more typical are temporary interest rate reductions, combined with capitalization of past-due interest, that result in very modest reductions in the present value of future cash flows.

Moreover, a 30% cure rate in today's environment is highly unrealistic. While the paper's authors cite the cure rate experienced for all loans 60 days delinquent or more, most servicers are unlikely to consider all 60-day past due loans as modification candidates. Servicers will also select out homeowners who can realistically refinance, which is the most common form of cure, and steer them towards that alternative. Thus, the self-cure probability for mortgages considered for possible modification is likely to be much lower than 30%.

Similarly, a 40% redefault rate has been the result, in part, of poor modification strategies. Most servicers have been increasing mortgage debt, and often increasing monthly payments, when modifying loans. Even modifications that reduced monthly payments in 2008 did not reduce them significantly, averaging about \$100 in payment reduction, or less than 10%. The OCC/OTS mortgage metrics report for the first quarter of 2009 demonstrates convincingly that modifications with significant payment reductions have much lower redefault rates. A modification program that includes both principal and monthly payment reductions should experience redefault rates in the 20% to 30% range.

The third important factor to consider is loss severities. Modifications are much less attractive to servicers who can recover 60% of the loan balance in a foreclosure than when they can only recover 35%. Loss severities actually experienced in 2009 by mortgage servicers have been rising steadily, and exceeded 65% in June 2009, i.e. servicers recovered less than 35% of the total debt in foreclosure sales.

Using real-world rates for loss severities, self-cure and redefault, and a well-designed modification program, mortgage servicers would clearly increase investor returns by modifying every mortgage where a homeowner has sufficient income to make a stream of payments worth at least 75% to 80% of the debt.

It is also the case that many homeowners are unable to afford their contractual payments, not because the payments have escalated, but because the loans were unaffordable at initiation, and/or because the homeowners have suffered a loss in income. Nevertheless, many homeowners may be able to make monthly payments sufficient to provide investors with 80% or more of the loan value, and servicers should be evaluating every loan with that possibility in mind. There is, unfortunately, no publicly available data on the current incomes of mortgage borrowers in default, so the ultimate question, i.e. how many foreclosures can be prevented, cannot realistically be answered. But it would be just as simplistic to say that all foreclosures are unavoidable as it is to say that all are preventable.

A final point bears mention. The only question considered by the Adelino paper is whether mortgage modifications result in a better return to the investors holding the mortgages. Foreclosures cause losses that are external to the mortgage contract, including to the values of neighboring properties (some of which are collateral for other lenders' mortgages) and to communities and local governments. Those losses can also be mitigated with a well-designed and fully implemented modification and debt reduction program. The Home Affordable program already provides some compensation to investors to encourage the reduction of these externalities, and further forms of compensation in conjunction with voluntary or mandatory mortgage modifications would be worth considering.