

# AT A CROSSROADS

## LESSONS FROM THE HOME AFFORDABLE MODIFICATION PROGRAM (HAMP)

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### EXECUTIVE SUMMARY

We stand, as a country, at a crossroads. We are beginning to emerge from the worst foreclosure crisis we have ever experienced. Multiple programs—federal, state, and private—have been adopted to address the crisis. More proposals are pending. In 2013, we will make decisions as a country about the direction we will take and the lessons we will learn.

The government's Home Affordable Modification Program (HAMP) is our starting point. HAMP has reached more homeowners, and successfully modified more home loans, than any program in history. Created by the federal government in early 2009 as a temporary program in response to the foreclosure crisis, HAMP provided additional financial incentives to servicers and investors to modify mortgages at risk of ending in foreclosure. The result has been affordable, sustainable loan modifications that keep borrowers in their homes and maximize returns to investors. But HAMP fell short of its goals, which were inadequate to the scope of the crisis. HAMP has been justly criticized for its lack of transparency and its failure to provide for effective enforcement.

This National Consumer Law Center report draws on available quantitative data and on the experience of attorneys and housing counselors around the country who have spent the last four years assisting homeowners struggling to access HAMP. The successes, failures, and missed opportunities of HAMP provide a roadmap for national loan modification standards, a key component of effective national mortgage servicing standards.

For most of the last four years, the foreclosure rate has been more than three times what it was in 1933, at the height of the Great Depression. And, by many estimates, we are not yet halfway through the devastation of lost homes, displaced families, and gutted neighborhoods. As of May 2012, nearly four million foreclosures had been completed since the beginning of the crisis five years ago in 2007. As many as another ten million homes are estimated to be at high risk. In addition to the economic and emotional toll on homeowners—particularly in communities of color and low-income communities—the loss to investors may reach more than two trillion dollars. Meanwhile, municipal budgets are strained by high numbers of abandoned properties and foreclosures weaken the housing market and overall economy.

In many cases, a modification of the terms of the mortgage is beneficial to homeowners and investors: a performing loan with affordable payments is often more profitable than a foreclosure. Nevertheless, many modifications that would benefit both homeowners

and investors are never offered because mortgage servicers have financial incentives that discourage modification. Preventable foreclosures put unnecessary downward pressure on the housing market and the broader economic recovery.

A number of government entities have made efforts recently to reform and improve servicing, loss mitigation, and loan modification practices. A piecemeal process involving multiple agencies threatens to result in rules that represent the least common denominator. We need uniform, strong mortgage servicing standards that put the entire industry on equal footing and give qualified homeowners access to efficient and enforceable mortgage servicing rules to save their homes. The content of these standards, regardless of which agency or agencies first adopts them, must be informed by the lessons of the last several years of loss mitigation efforts, particularly HAMP. By examining the HAMP experience, policymakers can shape servicing standards that will build on the program's successes and avoid its failures.

The key positive lesson of HAMP is that 'win-win' loan modifications are possible. Before HAMP, nearly half of all loan modifications failed. By contrast, over 80% of HAMP-compliant modifications are still performing a year after they have been made, and have substantially lower re-default and foreclosure rates than non-HAMP modifications. At the same time, HAMP protects investors' interests by requiring every potential modification to pass the net present value test. The test compares likely cash flow to investors from modifying the mortgage and from leaving the mortgage unchanged, taking into account the probability and cost of default under each scenario. Only modifications that are likely to save investors money satisfy the net present value test.

Yet, despite the benefits to homeowners and investors (and to the broader economy), servicers have failed to provide HAMP modifications to millions of eligible borrowers. In fact, the number of HAMP modifications started each month is actually *declining*, despite continued need for the program.

Although HAMP never covered the entire mortgage marketplace, HAMP's failure to reach its intended scale has one root cause: massive servicer noncompliance. Almost every official evaluation of HAMP has noted widespread servicer noncompliance and the concurrent failure of the U.S. Department of the Treasury (Treasury) to engage in meaningful enforcement. Of particular concern, servicers often fail to follow HAMP limitations on dual track servicing, the simultaneous pursuit of foreclosure and loan modification efforts. In consequence, servicers wrongfully conduct foreclosures and wrongfully sell homes before fully evaluating homeowners for modifications. Other examples of servicer noncompliance include mistakenly or falsely claiming investor restrictions as a reason for denying a loan modification and failing to provide required notices, leaving borrowers in costly uncertainty for months.

National loan modification standards should incorporate the successes of HAMP, which provided for increased access to sustainable modifications for many homeowners. But national loan modification standards must not fall into the same trap that HAMP did. Without strong mandates and real consequences for noncompliance, servicers will continue to implement modifications haphazardly or not at all, leaving the economy in a

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tailspin. Eligible homeowners must be able to rely directly on national servicing standards to save their homes from avoidable foreclosures.

Drawing on the lessons of HAMP, this report identifies five core principles for effective national loan modification standards: efficiency, affordability, accessibility, accountability, and enforceability (see page 6). These core principles for national loan modification standards will protect all market participants.

While the current period of historically high foreclosure rates will ebb, the crisis has exposed systemic faults in our mortgage markets generally and in mortgage servicing in particular that were hidden during the “good” days of rapid property appreciation and mortgage product innovation. National loan modification standards can directly address these failures in the market, can save millions of homes in the near future, and can reduce losses to investors, homeowners, and communities for decades to come.

With up to ten million homes at high risk for foreclosure in the next several years, we need uniform, strong, enforceable national mortgage standards now. The delay has cost trillions of dollars. But we can still seize the moment to transform the system of mortgage servicing from the chaos that currently reigns. We can protect both homeowners and investors. But the government must act now.

## Five Principles for National Loan Modification Mortgage Standards

1. **Efficiency: Loan modification evaluations should be standardized, universally applicable to all loans and servicers, and mandatory for all loans before the foreclosure process can go forward.**

Loan modifications must be mandated for qualified homeowners facing hardship where the modification also produces more income for the investor than foreclosure. Outreach to homeowners and loan modification evaluation should be completed before any steps are taken toward foreclosure. Where homeowners seek assistance only after initiation of a judicial or non-judicial foreclosure, the foreclosure should be paused until a full loan modification evaluation has been completed. This generally can be achieved without the servicer needing to start the foreclosure process over.

2. **Affordability: Loan modification terms must be affordable, fair, and sustainable.** HAMP has proved its worth by dramatically reducing re-default rates. National standards should follow HAMP's template by requiring affordable monthly payments and prioritizing interest rate reduction and principal forgiveness for long-term sustainability.
3. **Accessibility: Hardship must be defined to reflect the range of challenges homeowners face.** HAMP has put up barriers to access for many homeowners, including those with second mortgage debt, extended unemployment, subsequent hardships after modification and those who succeed to the mortgage after death or

divorce. The morass at servicers restricts access to HAMP for all homeowners, but particularly those with limited English proficiency. Reaching homeowners in need requires expansive eligibility rules and additional assistance for certain populations.

4. **Accountability: Transparency and accountability throughout the loan modification process are essential.** National loan modification standards must require transparency of all aspects of the modification process, from application through review and approval or denial. Servicers must be held to account for what they do and when they do it. The public must be given sufficient information in order to evaluate independently servicers' compliance.
5. **Enforceability: Homeowners must be protected from servicers' noncompliance. Good rules on paper are not enough.** National loan modification standards will only be effective if they are followed. In addition to rigorous enforcement by regulators and inclusion of a review of servicing practices in regular supervisory exams, homeowners must have the ability to appeal modification decisions and obtain independent review of their loan modification applications. To prevent unnecessary foreclosure, homeowners must be able to raise the failure to comply with any loan modification requirements as a defense to judicial or non-judicial foreclosure are reduced.