



# Preserving Homeownership: Foreclosure Prevention Initiatives

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## Summary

The foreclosure rate in the United States has been rising rapidly since the middle of 2006. Losing a home to foreclosure can hurt homeowners in many ways; for example, homeowners who have been through a foreclosure may have difficulty finding a new place to live or obtaining a loan in the future. Furthermore, concentrated foreclosures can drag down nearby home prices, and large numbers of abandoned properties can negatively affect communities. Finally, the increase in foreclosures may destabilize the housing market, which could in turn negatively impact the economy as a whole.

There is a broad consensus that there are many negative consequences associated with rising foreclosure rates. Both Congress and the Bush and Obama Administrations have initiated efforts aimed at preventing further increases in foreclosures and helping more families preserve homeownership. On February 18, 2009, President Obama announced the Making Home Affordable program, which aims to modify the loans of borrowers who are in danger of default or foreclosure. Other foreclosure prevention initiatives established prior to the creation of the Obama Administration's foreclosure prevention plan include the expired *FHASecure* program and the ongoing Hope for Homeowners program, both of which allowed troubled borrowers to refinance their loans into new mortgages backed by the Federal Housing Administration (FHA); Fannie Mae's and Freddie Mac's Streamlined Modification Plan, which has since been replaced by Making Home Affordable; and a program put in place by the Federal Deposit Insurance Corporation (FDIC) to help troubled borrowers with loans that had been owned by IndyMac Bank before it was taken over by the FDIC. Several states and localities have initiated their own foreclosure prevention efforts, as have private companies including Bank of America, JP Morgan Chase, and Citigroup. A voluntary alliance of mortgage lenders, servicers, investors, and housing counselors has also formed the HOPE NOW Alliance to reach out to troubled borrowers.

Additional efforts to address foreclosures are included in P.L. 111-22, the Helping Families Save Their Homes Act of 2009, signed into law by President Obama on May 20, 2009. The law makes changes to the Hope for Homeowners program and establishes a safe harbor for servicers who engage in certain loan modifications.

While many observers agree that slowing the pace of foreclosures is an important policy goal, there are several challenges associated with foreclosure mitigation plans. These challenges include implementation issues, such as deciding who has the authority to make mortgage modifications, developing the capacity to complete widespread modifications, and assessing the possibility that homeowners with modified loans will nevertheless default again in the future. Other challenges are related to the perception of fairness, the problem of inadvertently providing incentives for borrowers to default, and the possibility of setting an unwanted precedent for future mortgage lending.

This report describes the consequences of foreclosure on homeowners, outlines recent foreclosure prevention plans implemented by the government and private organizations, and discusses the challenges associated with foreclosure prevention. It will be updated as events warrant.

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## Introduction and Background

The foreclosure rate in the United States has been rising rapidly since around the middle of 2006. The large increase in home foreclosures since that time has negatively impacted individual households, local communities, and the economy as a whole. Consequently, an issue before Congress is whether to use federal resources and authority to help prevent further increases in home foreclosures and, if so, how to best accomplish this objective. This report details the impact of foreclosure on homeowners. It also describes recent attempts to preserve homeownership that have been implemented by the government and private lenders, and briefly outlines current proposals for further foreclosure prevention activities. It concludes with a discussion of some of the challenges inherent in designing foreclosure prevention initiatives. This report will be updated as events warrant.

Foreclosure refers to formal legal proceedings initiated by a mortgage lender against a homeowner after the homeowner has missed a certain number of payments on his or her mortgage.<sup>1</sup> When a foreclosure is completed, the homeowner loses his or her home, which is either repossessed by the lender or sold at auction to repay the outstanding debt. In general, the term “foreclosure” can refer to the foreclosure process or the completion of a foreclosure. This report deals primarily with preventing foreclosure completions.

In order for the foreclosure process to begin, two things must happen: a homeowner must fail to make a certain number of payments on his or her mortgage, and a lender must decide to initiate foreclosure proceedings rather than pursue other options (such as offering a repayment plan or a loan modification). A borrower that misses one or more payments is usually referred to as being delinquent on a loan; when a borrower has missed three or more payments, he or she is generally considered to be in default. Lenders can choose to begin foreclosure proceedings after a homeowner defaults on his or her mortgage, although lenders vary in how quickly they begin foreclosure proceedings after a borrower goes into default. Furthermore, the rules governing foreclosures, and the length of time the process takes, vary by state.

## Recent Market Trends

Home prices rose rapidly throughout some regions of the United States beginning in 2001. Housing has traditionally been seen as a safe investment that can offer an opportunity for high returns, and rapidly rising home prices reinforced this view. During this housing “boom,” many people decided to buy homes or take out second mortgages in order to access their increasing home equity. Furthermore, rising home prices and low interest rates contributed to a sharp increase in people refinancing their mortgages; for example, between 2000 and 2003, the number of refinanced mortgage loans jumped from 2.5 million to over 15 million.<sup>2</sup> Around the same time, subprime lending, which generally refers to making mortgage loans to individuals with credit scores that are too low to qualify for prime rate mortgages, also began to increase, reaching a peak between 2004 and 2006. However, beginning in 2006 and 2007, home sales started to

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<sup>1</sup> For a more detailed discussion of the foreclosure process and the factors that contribute to a lender’s decision to pursue foreclosure, see CRS Report RL34232, *The Process, Data, and Costs of Mortgage Foreclosure*, coordinated by Darryl E. Getter.

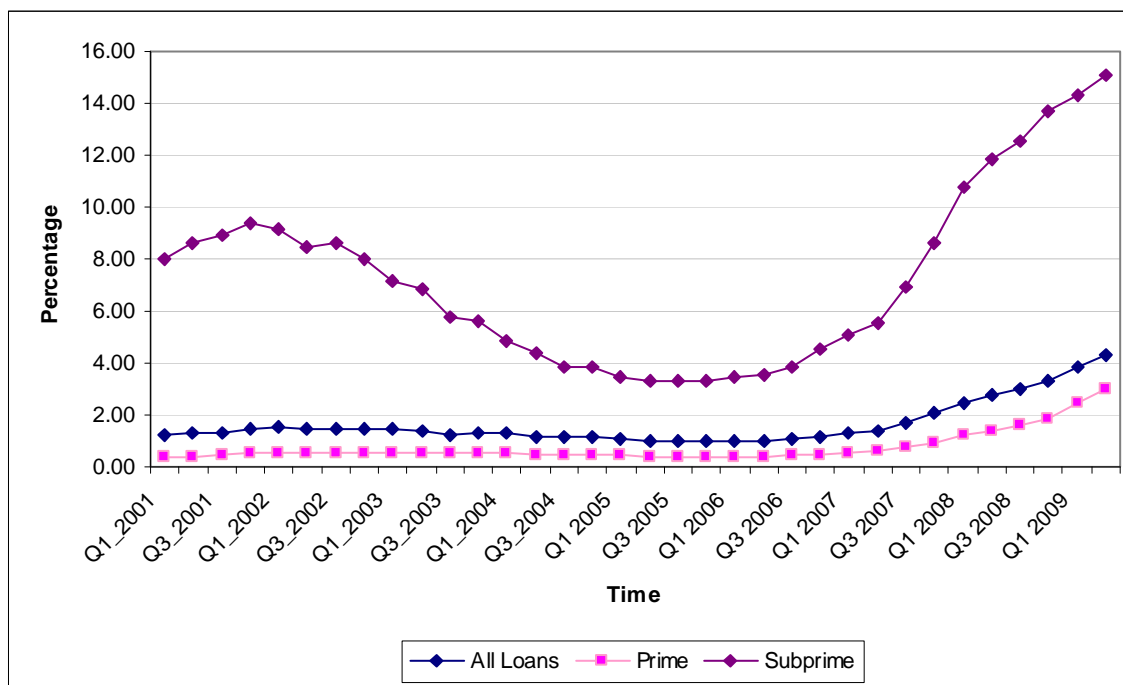
<sup>2</sup> U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *An Analysis of Mortgage Refinancing, 2001-2003*, November 2004, p.1, <http://www.huduser.org/Publications/pdf/MortgageRefinance03.pdf>.

decline, home prices stopped rising and began to fall in many regions, and the rates of homeowners becoming delinquent on their mortgages or going into foreclosure began to increase.

The percentage of home loans in the foreclosure process in the U.S. has been rising rapidly since the middle of 2006. Although not all homes in the foreclosure process will end in a foreclosure completion, an increase in the number of loans in the foreclosure process is generally accompanied by an increase in the number of homes on which a foreclosure is completed. According to the Mortgage Bankers Association, an industry group, about 1% of all home loans were in the foreclosure process in the second quarter of 2006. By the second quarter of 2009, the rate had quadrupled to over 4%.

The foreclosure rate for subprime loans has always been higher than the foreclosure rate for prime loans. For example, in the second quarter of 2006, just over 3.5% of subprime loans were in the foreclosure process compared to less than 0.5% of prime loans. However, both prime and subprime loans have seen similar increases in the foreclosure rate over the past several quarters. Like the foreclosure rate for all loans combined, the foreclosure rates for prime and subprime loans have both more than quadrupled, with the rate of subprime loans in the foreclosure process increasing to over 15% in Q1 2009 and the rate of prime loans in the foreclosure process increasing to 3% over the same time period. According to the Congressional Budget Office (CBO), observers expect the high rate of foreclosures to continue throughout 2009 and beyond.<sup>3</sup> **Figure 1** illustrates the trend in the rate of mortgages in the foreclosure process over the past several years.

**Figure 1. Percentage of Loans in Foreclosure by Type of Loan**



**Source:** Figure created by CRS using data from the Mortgage Bankers Association.

<sup>3</sup> Statement of Douglas W. Elmendorf, Director, Congressional Budget Office, testimony before the U.S. Congress, Senate Committee on the Budget, *Federal Response to the Housing and Financial Crisis*, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., January 28, 2009, p. 17, [http://cbo.gov/ftpdocs/99xx/doc9971/01-28-FinancialMarkets\\_Testimony.pdf](http://cbo.gov/ftpdocs/99xx/doc9971/01-28-FinancialMarkets_Testimony.pdf).

**Notes:** The Mortgage Bankers Association (MBA) is one of several organizations that reports delinquency and foreclosure data, but it does not represent all mortgages. MBA estimates that its data cover about 80% of outstanding first-lien mortgages on single-family properties.

## Impacts of Foreclosure

Losing a home to foreclosure can have a number of negative effects on a household. For many families, losing a home means losing the household's largest store of wealth. Furthermore, foreclosure can negatively impact a borrower's creditworthiness, making it more difficult for him or her to buy a home in the future. Finally, losing a home to foreclosure can also mean that a household loses many of the less tangible benefits of owning a home. Research has shown that these benefits include increased civic engagement that results from having a stake in the community, and better health, school, and behavioral outcomes for children.<sup>4</sup>

Some homeowners might have difficulty finding a place to live after losing their home to foreclosure. Many will become renters. However, some landlords may be unwilling to rent to families whose credit has been damaged by a foreclosure, limiting the options open to these families. There can also be spillover effects from foreclosure on current renters. Renters living in units facing foreclosure may be required to move, even if they are current on their rent payments. As more homeowners become renters and as more current renters are displaced when their landlords face foreclosure, pressure on local rental markets may increase, and more families may have difficulty finding affordable rental housing. Some observers have also raised the concern that a large increase in foreclosures could increase homelessness, either because families who lost their homes have trouble finding new places to live or because the increased demand for rental housing makes it more difficult for families to find adequate, affordable units.

If foreclosures are concentrated, they can also have negative impacts on communities. Many foreclosures in a single neighborhood may depress surrounding home values.<sup>5</sup> If foreclosed homes stand vacant for long periods of time, they can attract crime and blight, especially if they are not well-maintained. Concentrated foreclosures also place pressure on local governments, which can lose property tax revenue and may have to step in to maintain vacant foreclosed properties.

## The Policy Problem

There is a broad bipartisan consensus that the recent rapid rise in foreclosures is having negative consequences on households and communities. For example, Representative Spencer Bachus, Ranking Member of the House Committee on Financial Services, has said that "[i]t is in everyone's best interest as a general rule to prevent foreclosures. Foreclosures have a negative

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<sup>4</sup> For example, see Donald R. Haurin, Toby L. Parcel, and R. Jean Haurin, *The Impact of Homeownership on Child Outcomes*, Joint Center for Housing Studies, Harvard University, Low-Income Homeownership Working Paper Series, October 2001, <http://www.jchs.harvard.edu/publications/homeownership/liho01-14.pdf>, and Denise DiPasquale and Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, National Bureau of Economic Research, NBER Working Paper 6363, Cambridge, MA, January 1998, [http://www.nber.org/papers/w6363.pdf?new\\_window=1](http://www.nber.org/papers/w6363.pdf?new_window=1).

<sup>5</sup> For a review of the literature on the impact of foreclosures on nearby house prices, see Kai-yan Lee, *Foreclosure's Price-Depressing Spillover Effects on Local Properties: A Literature Review*, Federal Reserve Bank of Boston, Community Affairs Discussion Paper, No. 2008-01, September 2008, <http://www.bos.frb.org/commdev/pcadp/2008/pcadp0801.pdf>.

impact not only on families but also on their neighbors, their property value, and on the community and local government.”<sup>6</sup> Senator Chris Dodd, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, has described an “overwhelming tide of foreclosures ravaging our neighborhoods and forcing thousands of American families from their homes.”<sup>7</sup>

There is less agreement among policymakers about how much the federal government should do to prevent foreclosures. Proponents of enacting government policies and using government resources to prevent foreclosures argue that, in addition to being a compassionate response to the plight of individual homeowners, such action may prevent further damage to home values and communities that can be caused by concentrated foreclosures. Supporters also suggest that preventing foreclosures may help stabilize the economy as a whole. Opponents of government foreclosure prevention programs argue that foreclosure prevention should be worked out between lenders and borrowers without government interference. Opponents also express concern that people who do not really need help, or who are not perceived to deserve help, will unfairly take advantage of government foreclosure prevention programs. They argue that taxpayers’ money should not be used to help people who can still afford their loans but want to get more favorable terms, people who may be seeking to pass their losses on to the lender or the taxpayer, or people who knowingly took on mortgages that they could not afford.

Despite the concerns surrounding foreclosure prevention programs, and disagreement over the proper role of the government in preserving homeownership, Congress and the executive branch have both recently taken actions aimed at preventing foreclosures. Many private companies and state and local governments have also undertaken their own foreclosure prevention efforts. This report describes why so many households are currently at risk of foreclosure, outlines recent government and private initiatives to help homeowners remain in their homes, and discusses some of the challenges inherent in designing successful foreclosure prevention plans.

## **Why Might a Household Find Itself Facing Foreclosure?**

There are many reasons that a household might fall behind on its mortgage payments. Some borrowers may have simply taken out loans on homes that they could not afford. However, many homeowners who believed they were acting responsibly when they took out a mortgage nonetheless find themselves facing foreclosure. The reasons households might have difficulty making their mortgage payments include changes in personal circumstances, which can be exacerbated by macroeconomic conditions, and features of the mortgages themselves.

### **Changes in Household Circumstances**

Changes in a household’s circumstances can affect its ability to pay its mortgage. For example, a number of events can leave a household with a lower income than it anticipated when it bought its home. Such changes in circumstances can include a lost job, an illness, or a change in family structure due to divorce or death. Families that expected to maintain a certain level of income

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<sup>6</sup> Representative Spencer Bachus, “Remarks of Ranking Member Spencer Bachus During Full Committee Hearing on Loan Modifications,” press release, November 12, 2008, [http://bachus.house.gov/index.php?option=com\\_content&task=view&id=160&Itemid=104](http://bachus.house.gov/index.php?option=com_content&task=view&id=160&Itemid=104).

<sup>7</sup> Senator Chris Dodd, “Dodd Statement on Government Loan Modification Program,” statement, November 11, 2008, <http://dodd.senate.gov/?q=node/4620>.



may struggle to make payments if a household member loses a job or faces a cut in pay, or if a two-earner household becomes a single-earner household. Unexpected medical bills or other unforeseen expenses can also make it difficult for a family to stay current on its mortgage.

Furthermore, sometimes a change in circumstances means that a home no longer meets a family's needs, and the household needs to sell the home. These changes can include having to relocate for a job or needing a bigger house to accommodate a new child or an aging parent. Traditionally, households that needed to move could usually sell their existing homes. However, the recent decline in home prices in many communities nationwide has left some homeowners "underwater," meaning that borrowers owe more on their homes than the houses are worth. This limits homeowners' ability to sell their homes if they have to move; many of these families are effectively trapped in their current homes and mortgages because they cannot afford to sell their homes at a loss.

The risks presented by changing personal circumstances have always existed for anyone who took out a loan, but deteriorating macroeconomic conditions, such as falling home prices and increasing unemployment, have made families especially vulnerable to losing their homes for such reasons. The fall in home values that has left some homeowners owing more than the value of their homes not only traps those people in their current homes; it also makes it difficult for homeowners to sell their homes in order to avoid a foreclosure, and it increases the incentive for homeowners to walk away from their homes if they can no longer afford their mortgage payments. Along with the fall in home values, another recent macroeconomic trend has been increasing unemployment. More households experiencing job loss and the resultant income loss have made it difficult for many families to keep up with their monthly mortgage payments.

## **Mortgage Features**

Borrowers might also find themselves having difficulty staying current on their loan payments due in part to features of their mortgages. In the last several years, there has been an increase in the use of alternative mortgage products whose terms differ significantly from the traditional 30-year, fixed interest rate mortgage model.<sup>8</sup> While borrowers with traditional mortgages are not immune to delinquency and foreclosure, many of these alternative mortgage features seem to have increased the risk that a homeowner will have trouble staying current on his or her mortgage. Many of these loans were structured to have low monthly payments in the early stages and then adjust to higher monthly payments depending on prevailing market interest rates and/or the length of time the borrower held the mortgage. Furthermore, many of these mortgage features made it more difficult for homeowners to quickly build equity in their homes. Some examples of the features of these alternative mortgage products are listed below.

### ***Adjustable-Rate Mortgages***

With an adjustable-rate mortgage (ARM), a borrower's interest rate can change at predetermined intervals, often based on changes in an index. The new interest rate can be higher or lower than the initial interest rate, and monthly payments can also be higher or lower based on both the new

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<sup>8</sup> For a fuller discussion of these types of mortgage products and their effects, see CRS Report RL33775, *Alternative Mortgages: Causes and Policy Implications of Troubled Mortgage Resets in the Subprime and Alt-A Markets*, by Edward V. Murphy.

interest rate and any interest rate or payment caps.<sup>9</sup> Some ARMs also include an initial low interest rate known as a teaser rate. After the initial low-interest period ends and the new interest rate kicks in, the monthly payments that the borrower must make may increase, possibly by a significant amount.

Adjustable-rate mortgages make economic sense for some borrowers, especially if interest rates are expected to go down in the future. ARMs can help people own a home sooner than they may have been able to otherwise, or make sense for borrowers who cannot afford a high loan payment in the present but expect a significant increase in income in the future that would allow them to afford higher monthly payments. Furthermore, the interest rate on ARMs tends to follow short-term interest rates in the economy; if the gap between short-term and long-term rates gets very wide, it might make sense for borrowers to choose an ARM even if they expect interest rates to rise in the future. Finally, in markets with rising property values, borrowers with ARMs may be able to refinance their mortgages to avoid higher interest rates or large increases in monthly payments. However, if home prices fall, refinancing the mortgage or selling the home to pay off the debt may not be feasible, and homeowners can find themselves stuck with higher mortgage payments.

### *Zero-Downpayment or Low-Downpayment Loans*

As the name suggests, zero-downpayment and low-downpayment loans require either no downpayment or a significantly lower downpayment than has traditionally been required. These types of loans make it easier for homebuyers who do not have a lot of cash up-front to purchase a home. This type of loan may be especially useful in areas where home prices are rising more rapidly than income, because it allows borrowers without enough cash for a large downpayment to enter markets they could not otherwise afford. However, a low- or no-downpayment loan also means that families have little or no equity in their homes in the early phases of the mortgage, making it difficult to sell the home or refinance the mortgage in response to a change in circumstances if home prices decline. Such loans may also mean that a homeowner takes out a larger mortgage than he or she would otherwise.

### *Interest-Only Loans and Negative Amortization Loans*

With an interest-only loan, borrowers pay only the interest on a mortgage—but no part of the principal—for a set period of time. This option increases the homeowner’s monthly payments in the future, after the interest-only period ends and the principal amortizes. These types of loans limit a household’s ability to build equity in its home, making it difficult to sell or refinance the home in response to a change in circumstances if home prices are declining.

With a negative amortization loan, borrowers have the option to pay less than the full amount of the interest due for a set period of time. The loan “negatively amortizes” as the remaining interest is added to the outstanding loan balance. Like interest-only loans, this option increases future monthly mortgage payments when the principal and the balance of the interest amortizes. These

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<sup>9</sup> Even if the interest rate remains the same or decreases, it is possible for monthly payments to increase if prior payments were subject to an interest rate cap or a payment cap. This is because unpaid interest that would have accrued if not for the cap can be added to the principal loan amount, resulting in negative amortization. For more information on the many variations of adjustable rate mortgages, see The Federal Reserve Board, *Consumer Handbook on Adjustable Rate Mortgages*, [http://www.federalreserve.gov/pubs/arms/arms\\_english.htm#drop](http://www.federalreserve.gov/pubs/arms/arms_english.htm#drop).

types of loans can be useful in markets where property values are rising rapidly, because borrowers can enter the market and then use the equity gained from rising home prices to refinance into loans with better terms before payments increase. They can also make sense for borrowers who currently have low incomes but expect a significant increase in income in the future. However, when home prices stagnate or fall, interest-only loans and negative amortization loans can leave borrowers with negative equity, making it difficult to refinance or sell the home to pay the mortgage debt.

### ***Alt-A Loans***

Alt-A loans are mortgages that are similar to prime loans, but for one or more reasons do not qualify for prime interest rates. One example of an Alt-A loan is a low-documentation or no-documentation loan. These are loans to borrowers with good credit scores but little or no income or asset documentation. Although no-documentation loans allow for more fraudulent activity on the part of both borrowers and lenders, they may be useful for borrowers with income that is difficult to document, such as those who are self-employed or work on commission. Other examples of Alt-A loans are loans with high loan-to-value ratios or loans to borrowers with credit scores that are too low for a prime loan but high enough to avoid a subprime loan. In all of these cases, the borrower is charged a higher interest rate than he or she would be charged with a prime loan.

Many of these loan features may have played a role in the recent increase in foreclosure rates. Some homeowners were current on their mortgages before their monthly payments increased due to interest rate resets or the end of option periods. Some built up little equity in their homes because they were not paying down the principal balance of their loan or because they had not made a downpayment. Stagnant or falling home prices in many regions also hampered borrowers' ability to build equity in their homes. Borrowers without sufficient equity find it difficult to take advantage of options such as refinancing into a more traditional mortgage if monthly payments become too high or selling the home if their personal circumstances change.

## **Types of Loan Workouts**

When a household falls behind on its mortgage, there are options that lenders or servicers<sup>10</sup> may be able to employ as an alternative to beginning foreclosure proceedings. Some of these options, such as a short sale and a deed-in-lieu of foreclosure,<sup>11</sup> allow a homeowner to avoid the foreclosure process but still result in a household losing its home. This section describes methods

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<sup>10</sup> Mortgage lenders are the organizations that make mortgage loans to individuals. Often, the mortgage is managed by a separate company known as a servicer; servicers usually have the most contact with the borrower, and are responsible for actions such as collecting mortgage payments, initiating foreclosures, and communicating with troubled borrowers. Finally, many mortgages are repackaged into mortgage-backed securities (MBS) that are sold to institutional investors. Servicers are usually subject to contracts with mortgage lenders and MBS investors that may limit their ability to undertake loan workouts or modifications; the scope of such contracts and the obligations that servicers must meet vary widely.

<sup>11</sup> In a short sale, a household sells its home for less than the amount it owes on its mortgage, and the lender generally accepts the proceeds from the sale as payment in full on the mortgage even though it is taking a loss. A deed-in-lieu of foreclosure refers to the practice of a borrower turning the deed to the house over to the lender, which accepts the deed as payment of the mortgage debt.

of avoiding foreclosure that allow homeowners to keep their homes; these options generally take the form of repayment plans or loan modifications.

## **Repayment Plans**

A repayment plan allows a delinquent borrower to become up-to-date on his or her loan by paying back the payments he or she has missed, along with any accrued late fees. This is different from a loan modification, which changes one or more of the terms of the loan (such as the interest rate). Under a repayment plan, the missed payments and late fees may be paid back after the rest of the loan is paid off, or they may be added to the existing monthly payments. The first option increases the time that it will take for a borrower to pay back the loan, but his or her monthly payments will remain the same. The second option may result in an increase in monthly payments. Repayment plans may be a good option for homeowners who experienced a temporary loss of income but are now financially stable. However, since they do not generally make payments more affordable, repayment plans are unlikely to help homeowners with unaffordable loans avoid foreclosure in the long term.

## **Principal Forbearance**

Principal forbearance means that a lender or servicer removes part of the principal from the portion of the loan balance that is subject to interest, thereby lowering borrowers' monthly payments by reducing the amount of interest owed. The portion of the principal that is subject to forbearance still needs to be repaid by the borrower in full, usually after the interest-bearing part of the loan is paid off or when the home is sold. Because principal forbearance does not actually change any of the loan terms, it resembles a repayment plan more than a loan modification.

## **Principal Write-Downs/Principal Forgiveness**

A principal write-down is a type of mortgage modification that lowers borrowers' monthly payments by forgiving a portion of the loan's principal balance. The forgiven portion of the principal never needs to be repaid. Because the borrower now owes less, his or her monthly payment will be smaller. This option is costly for lenders but can help borrowers achieve affordable monthly payments, as well as increase the stake borrowers have in their homes and therefore increase their desire to stay current on the mortgage and avoid foreclosure.<sup>12</sup>

## **Interest Rate Reductions**

Another form of loan modification is when the lender voluntarily lowers the interest rate on a mortgage. This is different from a refinance, in which a borrower takes out a new mortgage with a lower interest rate and uses the proceeds from the new loan to pay off the old loan. Unlike refinancing, a borrower does not have to pay closing costs or qualify for a new loan to get an interest rate reduction, which makes interest rate reductions a good option for borrowers who owe

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<sup>12</sup> Historically, one impediment to principal forgiveness has been that borrowers were required to claim the forgiven amount as income, and therefore had to pay taxes on that income. Congress recently passed legislation that excludes mortgage debt forgiven before January 1, 2013 from taxable income. For more information about the tax treatment of principal forgiveness, see CRS Report RL34212, *Analysis of the Tax Exclusion for Canceled Mortgage Debt Income*, by Mark P. Keightley and Erika K. Lunder.

more on their mortgages than their homes are worth. With an interest rate reduction, the interest rate can be reduced permanently, or it can be reduced for a period of time before increasing again to a certain fixed point. Lenders can also freeze interest rates at their current level in order to avoid impending costly interest rate resets on adjustable rate mortgages. Interest rate modifications are relatively costly to the lender, but they can be effective at reducing monthly payments to an affordable level.

### **Extended Loan Term/Extended Amortization**

Another option for lowering monthly mortgage payments is extending the amount of time over which the loan is paid back. While extending the loan term increases the total cost of the mortgage for the borrower because more interest will accrue, it allows monthly payments to be smaller because they are paid over a longer period of time. Most mortgages in the U.S. have an initial loan term of 25 or 30 years; extending the loan term from 30 to 40 years, for example, could result in a lower monthly mortgage payment for the borrower.

## **Recent Foreclosure Prevention Initiatives**

The federal government, state and local governments, and private companies have all implemented a variety of plans to attempt to slow the recent increase in foreclosures. This section describes a number of recent foreclosure prevention initiatives.

### **Making Home Affordable**

On February 18, 2009, President Obama announced the Making Home Affordable (MHA) program, aimed at helping homeowners who are having difficulty making their mortgage payments avoid foreclosure.<sup>13</sup> (The program details originally referred to the program as the Homeowner Affordability and Stability Plan, or HASP. Further program details released on March 4, 2009, began referring to the plan as Making Home Affordable.) This plan is part of the Administration's broader economic recovery strategy, along with the Financial Stability Plan (an administrative initiative aimed at shoring up the financial system) and the American Recovery and Reinvestment Act of 2009 (enacted legislation (P.L. 111-5) aimed at stimulating the economy).<sup>14</sup>

Making Home Affordable includes three main parts. The first two parts of the plan allow certain homeowners to refinance or modify their mortgages. The third part of the plan provides additional financial support to Fannie Mae and Freddie Mac.

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<sup>13</sup> More information on the Administration's housing plan can be found at <http://www.financialstability.gov/roadtostability/homeowner.html>.

<sup>14</sup> For more information on the Financial Stability Plan, see <http://www.financialstability.gov/docs/fact-sheet.pdf>. For more information on the American Recovery and Reinvestment Act of 2009, see CRS Report R40537, *American Recovery and Reinvestment Act of 2009 (P.L. 111-5): Summary and Legislative History*, by Clinton T. Brass et al.

## **Home Affordable Refinance Program**

The first part of MHA is the Home Affordable Refinance Program (HARP). HARP allows homeowners with mortgages owned or guaranteed by Fannie Mae or Freddie Mac to refinance into loans with more favorable terms even if they owe more than 80% of the value of their homes. Generally, borrowers who owe more than 80% of the value of their homes have difficulty refinancing and therefore cannot take advantage of lower interest rates. By allowing borrowers who owe more than 80% of the value of their homes to refinance their mortgages, the plan is meant to help qualified borrowers lower their monthly mortgage payments to a level that is more affordable. Originally, qualified borrowers were eligible to refinance under this program if they owed up to 105% of the value of their homes. On July 1, 2009, the Administration announced that it is expanding the program to include borrowers who owe up to 125% of the value of their homes.

In addition to having a mortgage owned or guaranteed by Fannie Mae or Freddie Mac, a borrower must have a mortgage on a single-family home, live in the home as his or her primary residence, and be current on the mortgage payments in order to be eligible for this program. Rather than targeting homeowners who are behind on their mortgage payments, this piece of the MHA plan targets homeowners who have kept up with their payments but have lost equity in their homes due to falling home prices. Borrowers can apply for this part of the plan until June 2010.

The Administration estimates that the refinancing part of Making Home Affordable could help up to between 4 million and 5 million homeowners. According to a report from the Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac had refinanced over 116,500 loans with loan-to-value ratios above 80% as of September 30, 2009.<sup>15</sup>

## **Home Affordable Modification Program**

The second part of MHA is the Home Affordable Modification Program (HAMP). This part of the program encourages servicers to provide mortgage modifications for troubled borrowers in order to reduce the borrowers' monthly mortgage payments to no more than 31% of their monthly income. In order to qualify, a borrower must have a mortgage on a single-family residence that was originated on or before January 1, 2009, must live in the home as his or her primary residence, and must have an unpaid principal balance on the mortgage that is no greater than the Fannie Mae/Freddie Mac conforming loan limit in high-cost areas (\$729,750 for a one-unit property). Furthermore, the borrower must currently be paying more than 31% of his or her income toward mortgage payments, and must be experiencing a financial hardship that makes it difficult to remain current on the mortgage. Borrowers need not already be delinquent on their mortgage in order to qualify.

Servicers participating in the modification program will conduct a "net present value test" on eligible mortgages that compares the expected returns to investors from doing a loan modification to the expected returns from pursuing a foreclosure. If the expected returns from a loan modification are greater than those from foreclosure, servicers will reduce borrowers' payments to no more than 38% of monthly income, primarily using interest rate reductions but also using term extensions, principal forbearance, and principal forgiveness as needed. The government will

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<sup>15</sup> Federal Housing Finance Agency, "Refinance Report: September 2009," November 2, 2009, available at [http://www.fhfa.gov/webfiles/15153/Sept\\_Refinance\\_Final\\_report\\_and\\_release\\_11\\_2\\_09.pdf](http://www.fhfa.gov/webfiles/15153/Sept_Refinance_Final_report_and_release_11_2_09.pdf).

then match the lender dollar for dollar to reduce borrowers' payments from a 38% mortgage debt-to-income ratio (DTI) to a 31% DTI. Servicers can reduce interest rates to as low as 2%. The new interest rate must remain in place for five years; after five years, if the interest rate is below the market rate at the time the modification agreement was completed, the interest rate can rise by one percentage point per year until it reaches that rate. Borrowers must make modified payments on time during a three-month trial period before the modification is considered complete.

The Home Affordable Modification Program is voluntary, but the government will provide incentives for participation. Servicers will receive an incentive payment for each successful loan modification, an additional payment for modifications made for borrowers who are not yet delinquent, and a "pay for success" payment for up to three years if the borrower remains current after the modification. The borrower can also receive an incentive payment (in the form of principal reduction) for up to five years if he or she remains current after the modification is finalized. Lenders or investors can receive incentive payments for loans modified before a borrower becomes delinquent. Companies that receive funding through the Troubled Assets Relief Program (TARP) or the Financial Stability Plan (FSP) after the announcement of MHA will be required to participate in HAMP.

Since the program's announcement, the government has announced several additional details.<sup>16</sup> These details include the following:

- **Second Liens:** Many borrowers have second mortgages on their homes. Second mortgages can cause problems for loan modification programs because (1) modifying the first lien may not reduce households' total monthly mortgage payments to an affordable level if the second mortgage remains unmodified, and (2) holders of primary mortgages are often hesitant to modify the mortgage if the second mortgage holder does not agree to re-subordinate the second mortgage to the first mortgage. In order to address the issue of second liens, the government will share some of the costs of reducing borrowers' payments on second mortgages, and will offer lenders and borrowers smaller "pay for success" incentive payments for successfully modified second mortgages. In certain situations, lenders can also choose to extinguish second mortgages in exchange for a one-time payment from the government.
- **Short sales and deeds-in-lieu of foreclosure:** When a borrower is minimally eligible for MHA but does not ultimately qualify for a modification, the government will offer incentive payments to servicers who use short sales and deeds-in-lieu of foreclosure as alternatives to foreclosures. Borrowers can also receive incentive payments to help with relocation expenses when they successfully complete a short sale or deed-in-lieu of foreclosure. In order to attempt to streamline the process of short sales and deeds-in-lieu of foreclosure, the government will also provide standardized documentation and processes for servicers to use.

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<sup>16</sup> For more information on the additional Making Home Affordable program details described here, see "Making Home Affordable Program Update," April 28, 2009, at <http://www.financialstability.gov/docs/042809SecondLienFactSheet.pdf>, and "Making Home Affordable Update: Foreclosure Alternatives and Home Price Decline Protection Incentives," May 14, 2009, at <http://www.treas.gov/press/releases/docs/05142009FactSheet-MakingHomesAffordable.pdf>.

- **Home Price Decline Protection:** To encourage modifications even in markets where home prices are continuing to fall, lenders or investors will be eligible for Home Price Decline Protection incentive payments for successful modifications in areas with declining home prices. The incentive payments will be calculated according to the home price decline in the quarters prior to the loan modification in the area where the home is located and the average price of a home in that area. Total home price decline protection incentive payments will not exceed \$10 billion.
- **Hope for Homeowners Program:** The MHA program will require participating servicers to screen borrowers for eligibility for the Hope for Homeowners program (described later in this report) and to use that program for borrowers who qualify. Servicers who modify loans using Hope for Homeowners, and lenders who originate new loans under the program, will be eligible for incentive payments similar to those offered under Making Home Affordable.

HAMP will exist until December 31, 2012. The Administration estimates that HAMP will cost \$75 billion. Of this amount, \$50 billion will come from TARP funds and \$25 billion will come from Fannie Mae and Freddie Mac.<sup>17</sup>

The Administration estimates that HAMP could eventually help up to between 3 million and 4 million homeowners. The Treasury Department is releasing monthly reports detailing the program's progress. Currently, these reports include the number of overall trial modifications made under HAMP, the number of trial modifications made by individual servicers, the number of trial modifications underway in each state, and the number of trial modifications that have converted to permanent modifications. According to the November 2009 report, which includes data through November 26, 2009, over 759,000 trial modifications have begun since the program's inception. Of these, over 697,000 are currently active trial modifications, and nearly 31,400 have become permanent modifications.<sup>18</sup>

Many observers have expressed concern at the low number of trial modifications that have converted to permanent modifications to date. In order for a modification to become permanent, a borrower must make all of the trial period payments on time, and must submit all necessary documentation (such as tax returns and proof of income) to the servicer. On November 30, 2009, the Administration announced a number of steps that it will take to attempt to facilitate the conversion of trial modifications to permanent modifications. These steps include increased reporting requirements and monitoring of servicers, and outreach efforts to borrowers to help them understand and meet the program's documentation requirements.<sup>19</sup>

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<sup>17</sup> Department of the Treasury, Section 105(a) Troubled Assets Relief Program Report to Congress for the Period February 1, 2009 to February 28, 2009, p. 1, available at [http://www.financialstability.gov/docs/105CongressionalReports/105aReport\\_03062009.pdf](http://www.financialstability.gov/docs/105CongressionalReports/105aReport_03062009.pdf).

<sup>18</sup> U.S. Department of the Treasury, "Making Home Affordable Program: Servicer Performance Report Through November 2009," December 10, 2009, available at <http://www.financialstability.gov/docs/MHA%20Public%20121009%20FINAL.PDF>.

<sup>19</sup> U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, "Obama Administration Kicks Off Mortgage Modification Conversion Drive," press release, November 30, 2009, available at <http://treas.gov/press/releases/tg421.htm>.



## **Support for Fannie Mae and Freddie Mac**

The third piece of the Administration's housing plan provides additional financial support for Fannie Mae and Freddie Mac in an effort to maintain low mortgage interest rates. The Department of the Treasury will increase its Preferred Stock Purchase agreements from \$100 billion to \$200 billion for both Fannie Mae and Freddie Mac, and will increase the size of their portfolios by \$50 billion each. The funding for the increased preferred stock purchases was authorized by the Housing and Economic Recovery Act of 2008 (P.L. 110-289).

## **Hope for Homeowners**

Congress created the Hope for Homeowners program in the Housing and Economic Recovery Act of 2008 (P.L. 110-289), which was signed into law on July 30, 2008. The program, which is voluntary on the part of both borrowers and lenders, offers certain borrowers the ability to refinance into new mortgages insured by FHA if their lenders agree to certain loan modifications.

The Hope for Homeowners program began on October 1, 2008, and will remain in place until September 30, 2011. In order to be eligible for the program, borrowers must meet the following requirements:

- The borrower must have a mortgage that originated on or before January 1, 2008.
- The borrower's mortgage payments must have been more than 31% of their gross monthly income as of March 1, 2008.
- The borrower must not own another home.
- The borrower must not have intentionally defaulted on his or her mortgage, and he or she must not have been convicted of fraud during the last ten years under either federal or state law.
- The borrower must not have provided false information to obtain the original mortgage.

Under Hope for Homeowners, the lender agrees to write the mortgage down to a percentage of the home's currently appraised value, and the borrower receives a new loan insured by the FHA. The home must be reappraised by an FHA-approved home appraiser in order to determine its current value, and the lender absorbs whatever loss results from the write-down. The new mortgage is a 30-year fixed-rate mortgage with no prepayment penalties, and may not exceed \$550,440. Any second lien-holders are required to release their liens, and homeowners pay upfront and annual mortgage insurance premiums. When the homeowner sells or refinances the home, he or she is required to share between 50% and 100% of the proceeds with HUD depending on the length of time that passes between the time the borrower enters the program and when he or she sells the home. After one year, 100% of the equity in the home and any home value appreciation is shared with FHA, while after five years, only 50% is shared with FHA.

Under the original terms of the program, the lender was required to write the loan down to 90% of the home's currently appraised value. The upfront and annual mortgage insurance premiums were set at 3% and 1.5%, respectively, and second lien-holders were compensated for releasing their liens with a share of any future profit from the home's eventual sale.

On November 19, 2008, HUD announced three changes to Hope for Homeowners in order to simplify the program and encourage participation.<sup>20</sup> These changes did the following: (1) increased the maximum loan-to-value ratio of the new loan to 96.5% of the home's currently appraised value, instead of the original 90%, in order to minimize losses to lenders; (2) allowed lenders to increase the term of the mortgage from 30 to 40 years in order to lower borrowers' monthly payments; and (3) offered an immediate payment to second lien-holders, instead of a share in future profits, in return for their agreement to relinquish the lien.

Recent legislative and administrative developments made further attempts to increase participation in Hope for Homeowners. On May 20, 2009, President Obama signed into law P.L. 111-22, the Helping Families Save Their Homes Act of 2009. This law changes the Hope for Homeowners program by allowing reductions in both the upfront and annual mortgage insurance premiums that borrowers pay; allowing servicers to receive incentive payments for each loan they successfully refinance using Hope for Homeowners; and allowing HUD to reduce its share in any future home price appreciation and giving HUD the authority to share its stake in the home's future appreciation with the original lender or a second lien-holder. The law also places the Hope for Homeowners program under the control of the Secretary of HUD and limits eligibility for the program to homeowners whose net worth does not exceed a certain threshold.

The CBO originally estimated that up to 400,000 homeowners could be helped to avoid foreclosure over the life of the program.<sup>21</sup> As of mid-July 2009, the program had received 949 applications and 50 new mortgages had closed.<sup>22</sup> Some have suggested that more borrowers and lenders have not used Hope for Homeowners because the program is too complex. The legislative and administrative changes described above were intended to address some of the obstacles to participating in the program.

The Obama Administration has issued guidance for servicers on using Hope for Homeowners together with the Making Home Affordable program. This guidance requires servicers who are participating in the Making Home Affordable program to screen borrowers for eligibility for Hope for Homeowners and to use that program for qualified borrowers. The Administration's guidance also offers incentive payments to servicers who make modifications under Hope for Homeowners, and to lenders who originate new loans under the program.

## **Other Government Initiatives**

In addition to Making Home Affordable and Hope for Homeowners, a number of other programs have been created by federal, state, and local governments to attempt to stem the rise in

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<sup>20</sup> The authority to make these changes to Hope for Homeowners was granted in P.L. 110-343, the Emergency Economic Stabilization Act of 2008. The decision to make the changes was ultimately made by the Board of Hope for Homeowners, which includes the Secretary of HUD and the Secretary of the Treasury, among others.

<sup>21</sup> Congressional Budget Office, Cost Estimate, *Federal Housing Finance Regulatory Reform Act of 2008*, June 9, 2008, p. 8, [http://www.cbo.gov/ftpdocs/93xx/doc9366/Senate\\_Housing.pdf](http://www.cbo.gov/ftpdocs/93xx/doc9366/Senate_Housing.pdf).

<sup>22</sup> U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Preserving Homeownership: Progress Needed to Prevent Foreclosures*, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., July 16, 2009, hearing transcript available at <http://www.cq.com/display.do?dokey=/cqonline/prod/data/docs/html/transcripts/congressional/111/congressionaltranscripts111-000003168396.html@committees&metapub=CQ-CONGTRANSCRIPTS&searchIndex=0&seqNum=8>, and the Federal Housing Administration, *FHA Outlook*, July 1-15, 2009, available at <http://www.hud.gov/offices/hsg/comp/rpts/oe/olcurr.pdf>. Of the 50 loans that had closed under Hope for Homeowners as of July 16, 2009, only one had been insured by FHA.

foreclosures and help more homeowners remain in their homes. Although some of these programs are now obsolete, many continue to operate. This section describes other recent federal programs and briefly outlines some state and local foreclosure prevention efforts.

### *FHASecure*

*FHASecure* was a temporary program announced by the Federal Housing Administration (FHA) on August 31, 2007, to allow delinquent borrowers with non-FHA adjustable-rate mortgages (ARMs) to refinance into FHA-insured fixed-rate mortgages.<sup>23</sup> The new mortgage helped borrowers by offering better loan terms that either reduced a borrower's monthly payments or helped a borrower avoid steep payment increases under his or her old loan. *FHASecure* expired on December 31, 2008.

To qualify for *FHASecure*, borrowers originally had to meet the following eligibility criteria:

- The borrower had a non-FHA ARM that had reset.
- The borrower became delinquent on his or her loan due to the reset, and had sufficient income to make monthly payments on the new FHA-insured loan.
- The borrower was current on his or her mortgage prior to the reset. (Some borrowers with a minimum amount of equity in their homes could still be eligible for the program even if they had missed payments prior to the reset.)
- The new loan met standard FHA underwriting criteria and was subject to other standard FHA requirements (including maximum loan-to-value ratios, mortgage limits, and up-front and annual mortgage insurance premiums).

In July 2008, FHA expanded its eligibility criteria for the program, and borrowers had to meet the following revised eligibility requirements:

- The borrower became delinquent on his or her non-FHA ARM because of an interest rate reset or another extenuating circumstance, and had sufficient income to make monthly payments on the new FHA-insured loan.
- The borrower had no more than two payments that were 30 days late, or one payment that was 60 days late, in the twelve months preceding the interest rate reset or other extenuating circumstance.
- If the loan-to-value ratio on the FHA-insured mortgage was no higher than 90%, the borrower may have had no more than three payments that were 30 days late, or one payment that was 90 days late, prior to the interest rate reset or other extenuating circumstance.
- Borrowers with interest-only ARMs or option ARMs must have been delinquent due to an interest rate reset only (and not other extenuating circumstances), and must have been current on their mortgages prior to the reset; the revised eligibility criteria did not apply to these borrowers.

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<sup>23</sup> FHA already offered refinancing options for homeowners who were current on their existing fixed- or adjustable-rate mortgages and continued to do so after the adoption of *FHASecure*.

- The new loan met standard FHA underwriting criteria and was subject to other standard FHA requirements (including maximum loan-to-value ratios, mortgage limits, and up-front and annual mortgage insurance premiums).

*FHASecure* expired on December 31, 2008. In the months before its expiration, some housing policy advocates called for the program to be extended; however, HUD officials contended that continuing the program would be prohibitively expensive, possibly endangering FHA's single-family mortgage insurance program. HUD also points to the Hope for Homeowners program as filling the role that *FHASecure* did in helping households avoid foreclosure.<sup>24</sup> Supporters of extending *FHASecure* argued that the statutory requirements of Hope for Homeowners may offer less flexibility in the face of changing circumstances than *FHASecure*, which could have been more easily amended by HUD.

When *FHASecure* expired at the end of 2008, about 4,000 loans had been refinanced through the program.<sup>25</sup> Critics of the program point to the relatively stringent criteria that borrowers had to meet to qualify for the program as a possible reason that more people did not take advantage of it.

### **IndyMac Loan Modifications**

On July 11, 2008, the Office of Thrift Supervision in the Department of the Treasury closed IndyMac Federal Savings Bank, based in Pasadena, California, and placed it under the conservatorship of the Federal Deposit Insurance Corporation (FDIC). In August 2008, the FDIC put into place a loan modification program for holders of mortgages either owned or serviced by IndyMac that were seriously delinquent or in danger of default, or on which the borrower was having trouble making payments because of interest rate resets or a change in financial circumstances.

The IndyMac program offers systematic loan modifications to qualified borrowers in financial trouble. The systematic approach means that all loan modifications follow the same basic formula to identify qualified borrowers and reduce their monthly payments in a uniform way. Such an approach is meant to allow more modifications to happen more quickly than if each loan was modified on a case-by-case basis.

In order to be eligible for a loan modification, the mortgage must be for the borrower's primary residence and the borrower must provide current income information that documents financial hardship. Furthermore, the FDIC will conduct a net present value test to evaluate whether the expected future benefit to the FDIC and the mortgage investors from modifying the loan is greater than the expected future benefit from foreclosure.

If a borrower meets the above conditions, the loan is modified so that he or she has a mortgage debt-to-income ratio of 38%, meaning that the borrower's monthly mortgage payments (including principal, interest, taxes, and insurance) cannot exceed 38% of his or her monthly income. The goal is to lower a borrower's monthly payments to a level that is sustainable based on the borrower's current income. The 38% DTI can be achieved by lowering the interest rate, extending

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<sup>24</sup> HUD Mortgagee Letter 08-41, "Termination of *FHASecure*," December 19, 2008, available at <http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2008ml.cfm>.

<sup>25</sup> Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009 to 2019," January 2009, available at <http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf>.

the period of the loan, forbearing a portion of the principal, or a combination of the three. The interest rate is set at the Freddie Mac survey rate for conforming mortgages, but if necessary it can be lowered for a period of up to five years in order to reach the 38% DTI; after the five-year period, the interest rate rises by no more than 1% each year until it reaches the Freddie Mac survey rate.

FDIC Chairman Sheila Bair estimates that about 13,000 loans were modified under this program while IndyMac was under the FDIC's conservatorship.<sup>26</sup> The FDIC completed a sale of IndyMac to OneWest Bank on March 19, 2009. OneWest will continue the loan modification program, subject to the terms of a loss-sharing agreement with the FDIC.<sup>27</sup>

## **Fannie Mae and Freddie Mac**

Fannie Mae and Freddie Mac<sup>28</sup> are playing key roles in the Making Home Affordable program, described in an earlier section. In addition, they have undertaken a number of other efforts to help troubled borrowers with mortgages owned or guaranteed by Fannie or Freddie, and to help tenants in foreclosed properties that they own. These efforts have included the Streamlined Modification Plan (SMP), a mortgage modification plan that was implemented in December 2008 but has since been replaced by Making Home Affordable; foreclosure moratoria while the SMP was put into place; and offering month-to-month leases to qualified renters living in foreclosed properties so that they can remain in their homes.

### ***Streamlined Modification Plan***

On November 11, 2008, James Lockhart, the director of the Federal Housing Finance Agency (FHFA), which oversees Fannie Mae and Freddie Mac, announced a new Streamlined Modification Program that Fannie, Freddie, and certain private mortgage lenders and servicers planned to undertake.<sup>29</sup> Fannie Mae and Freddie Mac had helped troubled borrowers through individualized loan modifications for some time, but the SMP represented an attempt to formalize the process and set an industry standard. The SMP took effect on December 15, 2008, but has since been replaced by the Making Home Affordable plan, announced in February 2009 and described in an earlier section of this report.

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<sup>26</sup> Remarks by FDIC Chairman Sheila Bair to the National Association of Realtors Midyear Legislative Meeting and Trade Expo, Washington, D.C., May 12, 2009. A transcript of these remarks is available at <http://www.fdic.gov/news/news/speeches/chairman/spmay1209.html>.

<sup>27</sup> Federal Deposit Insurance Corporation, "FDIC Closes Sale of IndyMac Federal Bank, Pasadena, California," press release, March 19, 2009, <http://www.fdic.gov/news/news/press/2009/pr09042.html>.

<sup>28</sup> Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that were chartered by Congress to provide liquidity to the mortgage market. Rather than make loans directly, the GSEs buy loans made in the private market and either hold them in their own portfolios or securitize and sell them to investors. The GSEs were put under the conservatorship of FHFA on September 7, 2008. For more information on the GSEs in general, see CRS Report RL33756, *Fannie Mae and Freddie Mac: A Legal and Policy Overview*, by N. Eric Weiss and Michael V. Seitzinger, and for more information on the conservatorship, see CRS Report RS22950, *Fannie Mae and Freddie Mac in Conservatorship*, by Mark Jickling.

<sup>29</sup> The private mortgage lenders and servicers who participated in the Streamlined Modification Program are primarily members of the HOPE NOW Alliance, a voluntary alliance of industry members that formed to help homeowners avoid foreclosure. The HOPE NOW Alliance, and its involvement with the SMP, is described in detail in this report.

In order for borrowers whose mortgages were owned by Fannie Mae or Freddie Mac to be eligible for the SMP, they had to meet the following criteria:

- The mortgage must have originated on or before January 1, 2008.
- The mortgage must have had a loan-to-value ratio of at least 90%.
- The home must have been a single-family residence occupied by the borrower, and it must have been the borrower's primary residence.
- The borrower must have missed at least three mortgage payments.
- The borrower must not have filed for bankruptcy.

Mortgages insured or guaranteed by the federal government, such as those guaranteed by FHA, the Veterans' Administration, or the Rural Housing Service, were not eligible for the SMP.

The SMP shared many features of the FDIC's plan to modify troubled mortgages held by IndyMac. Borrowers who qualified for the program had to provide income information that was current within the last 90 days to the mortgage servicer. Based on this updated income information, borrowers' monthly mortgage payments were lowered so that the household's mortgage debt-to-income ratio was 38% (not including second lien payments). After borrowers successfully completed a three-month trial period (by making all of the payments at the proposed modified payment amount), the loan modification automatically took effect.

In order to reach the 38% mortgage debt-to-income ratio, servicers were required to follow a specific formula. First, the servicer capitalized late payments and accrued interest (late fees and penalties were waived). If this resulted in a DTI of 38% or less, the modification was complete. If the DTI was higher than 38%, the servicer could extend the term of the loan to up to 40 years from the effective date of the modification. If the DTI was still above 38%, the interest rate could be adjusted to the current market rate or lower, but to no less than 3%. Finally, if the DTI was still above 38% after the first three steps were taken, servicers could offer principal forbearance. The amount of the principal forbearance would not accrue interest and was non-amortizing, but would result in a balloon payment when the loan was paid off or the home was sold.

Negative amortization was not allowed under the SMP, nor were principal forgiveness or principal write-downs. In order to encourage participation in the SMP, Fannie Mae and Freddie Mac paid servicers \$800 for each loan modification completed through the program. If the SMP did not produce an affordable payment for the borrower, servicers were to work with borrowers in a customized fashion to try to modify the loan in a way that the homeowner could afford.

Fannie Mae and Freddie Mac completed over 51,000 loan modifications between January 2009 and April 2009, when Fannie and Freddie stopped using the SMP and began participating in the Making Home Affordable program instead.<sup>30</sup> However, it is unclear how many of these loan modifications were done specifically through the SMP.

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<sup>30</sup> Federal Housing Finance Agency, "Foreclosure Prevention Report: April 2009," July 15, 2009, available at [http://www.fhfa.gov/webfiles/14588/April\\_Foreclosure\\_Prevention71509F.pdf](http://www.fhfa.gov/webfiles/14588/April_Foreclosure_Prevention71509F.pdf).

### ***Foreclosure Moratoria***

On November 20, 2008, Fannie Mae and Freddie Mac announced that they would suspend foreclosure sales and evictions between November 26, 2008, and January 9, 2009, in order to have time to reach out to borrowers who might be eligible for loan modifications under the SMP. Fannie later extended its moratorium through March 31, 2009, and Freddie extended its moratorium through April 1, 2009.

### ***Renter Policies***

In January 2009, Fannie Mae and Freddie Mac each announced policies to allow qualified renters living in foreclosed single-family properties owned by Fannie or Freddie, respectively, to remain in their homes under new month-to-month leases.<sup>31</sup> Freddie Mac's policy also allows qualified former owner-occupants to remain in foreclosed homes as renters under new month-to-month leases.

### **Federal Reserve**

On January 27, 2009, the Federal Reserve announced the Homeownership Preservation Policy.<sup>32</sup> This plan provides guidelines to prevent foreclosures on residential mortgages that the Federal Reserve Banks hold, own, or control subject to Section 110 of the Emergency Economic Stabilization Act of 2008 (EESA), such as mortgage assets that they may receive as collateral for lending to troubled banks.

In order to be eligible for a loan modification under the Homeownership Preservation Policy, a borrower must be at least 60 days delinquent (although the Fed may make exceptions for households experiencing circumstances that are likely to result in their becoming at least 60 days delinquent). If the expected net present value of a loan modification is greater than the expected net present value of foreclosure, the Fed will modify mortgages by reducing the interest rate, extending the loan term, offering principal forbearance or principal forgiveness, or changing other loan terms. The modified mortgage must have a fixed interest rate, a term of no more than 40 years, and result in a mortgage debt-to-income ratio of no more than 38% for the borrower. The Fed must also have a reasonable expectation that the borrower will be able to repay the modified loan. If the borrower's mortgage debt is greater than 125% of the current estimated value of the property, the Fed will prioritize principal reductions over other types of loan modifications where possible.

This policy applies to whole mortgages that the Federal Reserve Banks hold, own, or control. In the case of securitized mortgages in which the Fed has an interest, the Fed will encourage servicers to undertake similar loan modifications and support their efforts to do so.

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<sup>31</sup> For more information, see "Fannie Mae Announces National REO Rental Policy," press release, January 13, 2009, at <http://www.fanniemae.com/newsreleases/2009/4581.jhtml?p=Media&s=News+Releases>, and "Freddie Mac Extends Eviction Suspension Until March, Launches Rental Option for Foreclosed Borrowers, Tenants," press release, January 30, 2009, at [http://www.freddie.com/news/archives/servicing/2009/20090130\\_reo-rental.html](http://www.freddie.com/news/archives/servicing/2009/20090130_reo-rental.html).

<sup>32</sup> Details of the Homeownership Preservation Policy can be found on the Federal Reserve's website at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090130a1.pdf>.

## **Foreclosure Counseling Funding to NeighborWorks America**

Another federal effort to slow the rising number of foreclosures has been to appropriate additional funding for housing counseling. In particular, Congress has recently appropriated funding specifically for foreclosure mitigation counseling to be administered by NeighborWorks America, a non-profit created by Congress in 1978 that has a national network of community partners.<sup>33</sup> NeighborWorks traditionally provides housing counseling to homebuyers and homeowners through its network organizations, and also trains other non-profit housing counseling organizations in foreclosure counseling.

The Consolidated Appropriations Act, 2008 (P.L. 110-161) appropriated \$180 million for NeighborWorks to distribute for foreclosure mitigation counseling, which it has done by setting up the National Foreclosure Mitigation Counseling Program (NFMCP).<sup>34</sup> NeighborWorks competitively awards the funding to qualified housing counseling organizations.<sup>35</sup> Congress directed NeighborWorks to award the funding with a focus on areas with high default and foreclosure rates on subprime mortgages. The Housing and Economic Recovery Act of 2008 (P.L. 110-289) appropriated an additional \$180 million for NeighborWorks to distribute through the NFMCP, \$30 million of which was to be distributed to counseling organizations to provide legal help to homeowners facing delinquency or foreclosure. The Omnibus Appropriations Act, 2009 (P.L. 111-8) included \$50 million for NeighborWorks to distribute through the NFMCP.

## **Foreclosure Mitigation Efforts Targeted to Servicemembers**

The federal government has made a number of efforts to prevent foreclosures specifically among members of the Armed Forces. The Servicemembers Civil Relief Act (P.L. 108-189), which became law on December 19, 2003, prohibits foreclosure completions on properties owned by servicemembers during a period of military service or within 90 days of the servicemember's return from military service.<sup>36</sup> The law also prohibits evictions of active servicemembers or their dependents, subject to certain conditions. The Housing and Economic Recovery Act of 2008 (P.L. 110-289) temporarily extended the prohibition on foreclosure completions from 90 days to nine months after a servicemember's return from military service, until the end of 2010, and also directed the Secretary of Defense to develop a foreclosure counseling program for members of the Armed Forces returning from active duty abroad.

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<sup>33</sup> Each year, Congress appropriates funding to HUD to distribute to certified housing counseling organizations to undertake various types of housing counseling, including pre-purchase counseling and post-purchase counseling. Congress also appropriates funding to NeighborWorks each year for neighborhood reinvestment activities, including housing counseling. The recent funding appropriated specifically for foreclosure mitigation counseling is separate from both of these other usual appropriations.

<sup>34</sup> For more information on the National Foreclosure Mitigation Counseling Program, see the NeighborWorks website at <http://www.nw.org/network/nfmcp/default.asp#info>.

<sup>35</sup> HUD-approved housing counseling intermediaries, state housing finance agencies, and NeighborWorks organizations are eligible to receive funds through the NFMCP.

<sup>36</sup> This law is a revision of the Soldiers' and Sailors' Civil Relief Act of 1940 (P.L. 76-861), which itself was a revision of the Soldiers' and Sailors' Civil Relief Act of 1918 (P.L. 65-103). Both earlier laws also included foreclosure protections for members of the military on or recently returned from active duty.



## **State and Local Initiatives**

In addition to federal efforts to prevent foreclosures, a number of state and local governments have implemented their own programs aimed at helping homeowners stay in their homes. Some of these efforts include supporting voluntary or mandatory pre-foreclosure counseling initiatives, imposing foreclosure moratoria, providing short-term loans to help homeowners at risk of foreclosure, enacting stronger reporting requirements on lenders' loan modification efforts, and initiating legal actions. Many states and localities have also implemented educational efforts to reach out to troubled homeowners.

According to the Pew Charitable Trusts Center on the States, as of April 2008, 20 states have laws or regulations involving foreclosure mitigation, 24 states have statewide counseling efforts, 13 states have a foreclosure intervention hotline, and 9 states have developed loan funds to help homeowners refinance into more affordable mortgages or to provide short-term loans to borrowers facing foreclosure. Furthermore, at least 14 states have created foreclosure prevention task forces to attempt to address the problem of rising foreclosure rates.<sup>37</sup>

## **Private Initiatives**

While the government has initiated the mortgage modification programs described above, a number of private mortgage lenders and servicers have voluntarily attempted to implement their own foreclosure prevention initiatives. Many private lenders have engaged in ongoing individual loan modifications for some time, but have recently launched more targeted programs to help troubled borrowers. This section describes some of these programs in order to provide illustrative examples of private sector initiatives to prevent foreclosures; it is not intended to be a comprehensive list of private foreclosure prevention efforts.

### **HOPE NOW Alliance**

The HOPE NOW Alliance is a voluntary alliance of mortgage servicers, lenders, investors, counseling agencies, and others that formed in October 2007. The alliance is a private sector initiative created with the encouragement of the federal government to engage in active outreach efforts to troubled borrowers. Member organizations identify borrowers who may have difficulty making loan payments before they become seriously delinquent on their mortgages, and work with such borrowers to work out loan modifications that can keep the borrowers in their homes. When the alliance was first announced, eleven mortgage servicers were involved; by November 2008, 27 servicers had become member organizations.

HOPE NOW Alliance members have undertaken several initiatives to help troubled homeowners. One such initiative the alliance has supported is a hotline, operated by the Homeownership Preservation Foundation, that connects borrowers to HUD-approved housing counselors who can help homeowners contact their servicers and work out a plan to avoid foreclosure. The hotline

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<sup>37</sup> The Pew Charitable Trusts Center on the States, *Defaulting on the Dream: States Respond to America's Foreclosure Crisis*, April 2008, [http://www.pewcenteronthestates.org/uploadedFiles/PCS\\_DefaultingOnTheDream\\_Report\\_FINAL041508\\_01.pdf](http://www.pewcenteronthestates.org/uploadedFiles/PCS_DefaultingOnTheDream_Report_FINAL041508_01.pdf).

serves as a first point of contact for troubled borrowers, and both HUD and non-profit organizations such as NeighborWorks America advocate its use.<sup>38</sup>

HOPE NOW also encourages its lenders and servicers to coordinate their efforts to modify mortgages. On December 6, 2007, the HOPE NOW Alliance announced a streamlined plan that would allow servicers to freeze the interest rate on certain subprime ARMs for borrowers who were current on their mortgages but would not be able to afford higher payments after their rates reset. While the plan received assurances from the government that the modifications would not affect certain accounting or tax issues surrounding securitized loans, servicers who went forward with modifications could not be certain that investors would not mount legal challenges.<sup>39</sup> Most recently, HOPE NOW announced on November 11, 2008, that most of its servicers would participate in the SMP (described earlier in this report), with the idea that the plan would create a new industry-wide approach to mortgage modifications.

According to HOPE NOW's own reports, the alliance expected to prevent 2.2 million foreclosures and complete almost 950,000 loan modifications in 2008 through these efforts.<sup>40</sup> However, some of these prevented foreclosures are the result of solutions other than loan modifications. These other solutions could include repayment plans, under which it is possible that some borrowers could end up with higher, not lower, monthly payments, and which may not substantially reduce the risk that these homeowners will eventually end up in default or foreclosure. They could also involve short sales or deeds-in-lieu-of-foreclosure, in which the homeowner avoids the foreclosure process but still loses the home.

## **Bank of America**

On October 6, 2008, Bank of America announced a loan modification program for homeowners whose mortgages are serviced by Countrywide. (Countrywide was acquired by Bank of America on July 1, 2008.)<sup>41</sup> The program became effective December 1, 2008, and targets borrowers who are seriously delinquent, or in danger of becoming seriously delinquent, on their mortgages due to loan features such as interest rate resets.

The Bank of America program aims to reduce borrowers' mortgage debt to no more than 34% of gross monthly income for the first year of the modification. Subsequent rises in the interest rate or other loan terms are structured in a way that minimizes payment shock to the borrower. Types of loan modifications can include using the Hope for Homeowners program, described above, to help homeowners refinance into FHA-insured mortgages; reducing the interest rate; and reducing the principal balance on option-ARMs. Eligibility for the program is limited to primary residences.

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<sup>38</sup> The phone number for the HOPE NOW Alliance hotline is 888-995-HOPE (4673).

<sup>39</sup> For more information on the tax and accounting issues surrounding this plan, see CRS Report RL34372, *The HOPE NOW Alliance/American Securitization Forum (ASF) Plan to Freeze Certain Mortgage Interest Rates*, by David H. Carpenter and Edward V. Murphy.

<sup>40</sup> The HOPE NOW Alliance, "HOPE NOW Projects Big Increases in Foreclosure Prevention Successes in 2009," press release, Dec. 22, 2008, available online at [http://www.hopenow.com/press\\_release/files/HOPE%20NOW%202008%20Year%20End%20-%20November%20Data%20Release.pdf](http://www.hopenow.com/press_release/files/HOPE%20NOW%202008%20Year%20End%20-%20November%20Data%20Release.pdf).

<sup>41</sup> Bank of America, "Bank of America Announces Nationwide Homeownership Retention Program for Countrywide Customers," press release, October 6, 2008, [http://newsroom.bankofamerica.com/index.php?s=press\\_releases&item=8272](http://newsroom.bankofamerica.com/index.php?s=press_releases&item=8272).

In addition to its own foreclosure prevention efforts, Bank of America is a participating servicer in the Administration's Making Home Affordable plan.

## **JP Morgan Chase**

On October 31, 2008, JP Morgan Chase announced an expansion of its foreclosure prevention efforts.<sup>42</sup> This expansion includes reaching out to borrowers before they begin to miss payments, and conducting a systematic review of all of the mortgages held by Chase to ascertain which borrowers might be eligible for loan modifications. Chase will offer troubled borrowers a combination of reductions in their interest rate and principal forbearance, and will review each mortgage before it enters the foreclosure process to ensure that eligible borrowers were offered loan modifications. Chase specifically excludes negative amortization as a loan modification option. Chase also announced that it would not begin any foreclosures while the expanded program was being implemented.

In order to be eligible for a loan modification, borrowers must have a mortgage that is owned by Chase, Washington Mutual, or EMC. (EMC and Washington Mutual were acquired by JP Morgan Chase in March 2008 and September 2008, respectively.) If a borrower's mortgage is serviced, but not owned, by one of these companies, the investors must give permission for the loan to be modified. To be eligible, borrowers must occupy the home as their primary residence.

In addition to its own foreclosure prevention efforts, JP Morgan Chase is a participating servicer in the Administration's Making Home Affordable plan.

## **Citigroup**

On November 11, 2008, Citigroup announced that it was streamlining its existing mortgage modification program in the mold of the IndyMac loan modification model.<sup>43</sup> Under the streamlined program, Citigroup uses a formula to arrive at a certain mortgage payment-to-income ratio, and then uses a combination of interest rate reductions, extensions of the loan term, or forgiveness of part of the principal in order to reach that ratio. Citigroup also announced the Citi Homeowner Assistance program, in which it pledged to reach out to borrowers who were not yet delinquent on their mortgages but who were in danger of falling behind on their loan payments. Through this program, Citigroup plans to concentrate its efforts on geographic areas that are especially economically hard-hit, such as those areas experiencing steep home price declines or rapid rises in unemployment. Finally, Citigroup has announced a foreclosure moratorium in order to give it more time to reach out to borrowers and complete loan modifications.

Currently, these programs are in effect for mortgage loans that Citigroup owns. Citi is working with investors to expand the program to include mortgages that are serviced, but not owned, by Citigroup.

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<sup>42</sup> JP Morgan Chase, "Chase Further Strengthens Robust Programs to Keep Families in Homes," press release, October 31, 2008, <http://files.shareholder.com/downloads/ONE/514430481x0x245621/b879b4eb-40c0-43f8-8614-6f2113759d0c/344473.pdf>.

<sup>43</sup> Citigroup, "Citi Announces New Preemptive Initiatives to Help Homeowners Remain in Their Homes," press release, November 11, 2008, <http://www.citigroup.com/citi/press/2008/081111a.htm>.

On March 3, 2009, Citigroup announced an expansion to its Homeowner Assistance Program targeted at borrowers who recently became unemployed.<sup>44</sup> Borrowers with mortgages that are both owned and serviced by CitiMortgage and who are currently unemployed may be eligible to make reduced mortgage payments for three months. An eligible borrower must be at least 60 days delinquent or in foreclosure, must live in the home as his or her primary residence, and must meet certain other eligibility requirements.

In addition to its own foreclosure prevention efforts, CitiMortgage is a participating servicer in the Administration's Making Home Affordable plan.

## **Other Foreclosure Prevention Proposals**

Some observers argue that the programs outlined above, which have already been implemented by various government and private organizations, have not been effective enough at stopping the rising foreclosure rate and keeping people in their homes. This section briefly outlines some existing proposals for further action to help prevent foreclosures.

### **Changing Bankruptcy Law**

One method that has been suggested to help more homeowners remain in their homes is to amend bankruptcy law to allow a judge to order a mortgage loan modification as part of a bankruptcy proceeding. Bankruptcy judges currently have the authority to modify or reduce other types of outstanding debt obligations, including mortgages on second homes and vacation homes, but this authority does not extend to mortgages on primary residences. Opponents of such a change do not want judges to have such broad power to amend a contract after the fact. They argue that allowing these "cramdowns" would make lenders more hesitant to make mortgage loans in the future, since the threat of a loan being modified in this way could make mortgage lending more risky. Supporters of amending bankruptcy law say that, in addition to helping a borrower in bankruptcy avoid foreclosure through a court-mandated loan modification, such a change might also encourage lenders to work with borrowers to modify loans before the bankruptcy process begins in the first place.

Provisions to amend bankruptcy law to allow judges to modify mortgages on primary residences were included in H.R. 1106, the Helping Families Save Their Homes Act of 2009, which passed the House on March 5, 2009. However, bankruptcy provisions were not included in the Senate's version of the bill, S. 896, which passed the Senate on May 6, 2009. A modified version of the Senate bill was signed into law (P.L. 111-22) on May 20, 2009, without the cramdown provision. (For a description of recent legislative proposals to amend bankruptcy law to allow judges to order mortgage modifications, see CRS Report RL34301, *The Primary Residence Exception: Legislative Proposals in the 111<sup>th</sup> Congress to Amend the Bankruptcy Code to Allow the Strip Down of Certain Home Mortgages*, by David H. Carpenter.)

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<sup>44</sup> Citigroup, "Citi Expands Homeowner Assistance Program to Help Recently Unemployed Borrowers Stay in Their Homes," press release, March 3, 2009, <http://www.citigroup.com/citi/press/2009/090303a.htm>.

## **Foreclosure Moratorium**

Some advocates have called for placing a temporary moratorium on foreclosure completions. Proponents of this idea argue that placing a freeze on foreclosure completions would give homeowners and lenders more time to work out sustainable loan modifications that would allow homeowners to remain in their homes and turn troubled mortgages back into performing loans that benefit the lenders. Opponents of a foreclosure moratorium argue that the government should not interfere with the right of a lender to complete foreclosure proceedings against a borrower who has defaulted on his or her loan. They note that delaying foreclosure proceedings through a foreclosure moratorium could result in greater losses for the lender if the ultimate outcome is still a foreclosure and the home's price has fallen further in the interim.

Fannie Mae, Freddie Mac, and some private lenders have instituted temporary foreclosure moratoria while they put foreclosure prevention programs in place. While a wider foreclosure moratorium had widely been considered a radical idea until recently, the severity of the increase in foreclosures and its impact on the economy has led some to give the idea serious consideration. (For an analysis of the economic principals behind a foreclosure moratorium, see CRS Report RL34653, *Economic Analysis of a Mortgage Foreclosure Moratorium*, by Edward V. Murphy. For an analysis of the legal issues involved, see CRS Report RL34369, *Constitutional Issues Relating to Proposals for Foreclosure Moratorium Legislation That Affects Existing Mortgages*, by David H. Carpenter.)

## **Issues and Challenges Associated with Preventing Foreclosures**

There are several challenges associated with designing successful programs to prevent foreclosures. Some of these challenges are practical and concern issues surrounding the implementation of loan modifications. Other challenges are more conceptual, and are related to questions of fairness and precedent. This section describes some of the most prominent considerations involved in programs to preserve homeownership.

### **Who Has The Authority to Modify Mortgages?**

In recent years, the practice of lenders packaging mortgages into securities and selling them to investors has become more widespread. This practice is known as securitization, and the securities that include the mortgages are known as mortgage-backed securities (MBS). When mortgages are sold through securitization, several players become involved with any individual mortgage loan, including the lender, the servicer, and the investors who hold shares in the MBS. The servicer is usually the organization that has the most contact with the borrower, including receiving monthly payments and initiating any foreclosure proceedings. However, servicers are usually subject to contracts with investors which limit the activities that the servicer can undertake and require it to safeguard the investors' profit. One major question facing foreclosure prevention programs, therefore, is who actually has the authority to make a loan modification. Contractual obligations may limit the amount of flexibility that servicers have to modify loans in ways that could arguably yield a lower return for investors. In some cases, loan modifications can result in less of a loss for investors than foreclosure; however, servicers may not want to risk having investors challenge their assessment that a modification is more cost-effective than a

foreclosure. This problem can be especially salient in streamlined programs in which large numbers of loans are modified at once. With such streamlined programs, the cost-effectiveness of loan modifications depends on questions such as how many loans would have likely ended up in foreclosure without the modification, making it more difficult to say whether wholesale loan modifications are in the best interest of investors.

One possible way to partially address the question of who can modify mortgages is to provide a safe harbor for servicers. In general, a safe harbor protects servicers who engage in certain mortgage modifications from lawsuits brought by investors. While proponents of a safe harbor believe that a safe harbor is necessary to encourage servicers to modify more mortgages without fear of legal repercussions, opponents argue that a safe harbor infringes on investors' rights and could even encourage servicers to modify mortgages that are not in trouble if it benefits their own self-interest. P.L. 111-22, the Helping Families Save Their Homes Act of 2009, provides a safe harbor for servicers who modify mortgages consistent with the Making Home Affordable program guidelines or by using the Hope for Homeowners program. The legislation specifies that the safe harbor does not protect servicers or individuals from liability for any fraud committed in their handling of the mortgage or the mortgage modification.

## **Volume of Delinquencies and Foreclosures**

Another issue facing loan modification programs is the sheer number of delinquencies and foreclosure proceedings underway. Lenders and servicers have a limited number of employees to reach out to troubled borrowers and find solutions. Contacting borrowers—some of whom may avoid contact with their servicer out of embarrassment or fear—and working out large numbers of individual loan modifications can overwhelm the capacity of the lenders and servicers who are trying to help homeowners avoid foreclosure. Streamlined plans that use a formula to modify all loans that meet certain criteria may make it easier for lenders and servicers to help a greater number of borrowers in a shorter amount of time. However, streamlined plans are more likely to run into the contractual issues between servicers and investors described above.

## **Possibility of Re-default**

Another major challenge associated with loan modification programs is the possibility that a homeowner who receives a modification will nevertheless default on the loan again in the future. This possibility is especially problematic if the home's value is falling, because in that case delaying an eventual foreclosure reduces the value that the lender can recoup through a foreclosure sale. Data released quarterly by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) show that over 40% of loans modified in the first quarter of 2008 were 30 or more days delinquent again three months after the modification, and 53% were 30 or more days delinquent six months after the modification. The same data show that a smaller percentage of modified loans were 60 or more days delinquent: over 23% of loans were 60 or more days delinquent three months after the modification, and nearly 37% were 60 or more days delinquent six months after the modification.<sup>45</sup> Re-default rates follow the same general pattern for loans modified in later quarters of 2008.

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<sup>45</sup> Office of the Comptroller of the Currency and Office of Thrift Supervision, "OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009," June 30, 2009, pp. 27-28, available at <http://files.ots.treas.gov/4820471.pdf>.

Opponents of aggressive loan modification programs point to these data as evidence that loan modifications are not effective at preventing foreclosures. However, proponents of such programs argue that the definition of loan modification used in these data is overly broad, and that many of the modifications did not actually result in lower monthly payments for the borrower.<sup>46</sup> These supporters believe that loan modifications that focus on creating truly affordable payments for troubled borrowers will exhibit lower rates of re-default.

The OCC and the OTS have begun to include data in their quarterly report that show re-default rates for loans modified in 2008 according to whether the loan modification increased monthly payments, decreased monthly payments, or left monthly payments unchanged. These data show that, six months after modification, the re-default rate for loan modifications that resulted in monthly payments being reduced by 20% or more was slightly over 24%. This compares to a re-default rate of nearly 29% for loans where monthly payments were reduced by between 10% and 20%; just over 36% for loans where payments were reduced by less than 10%; over 54% for loans where payments remained unchanged; and 50% for loans where monthly payments increased. While loan modifications that lower monthly payments do appear to perform better than modifications that increase monthly payments or leave them unchanged, a significant number of these loans still become delinquent again after the loan modification.<sup>47</sup>

## **Fairness Issues**

Opponents of some foreclosure prevention plans argue that it is not fair to help homeowners who have fallen behind on their mortgages while homeowners who have been scraping by to stay current receive no help. Others argue that borrowers who got in over their heads, particularly if they intentionally took out mortgages that they knew they could not afford, should face consequences. Supporters of loan modification plans point out that many borrowers go into foreclosure for reasons outside of their control, and that some troubled borrowers may have been victims of deceptive, unfair, or fraudulent lending practices. Furthermore, a case can be made that foreclosure prevention programs are necessary not only out of compassion for the homeowner, but because foreclosures can create problems for other homeowners in the neighborhood by dragging down property values or putting a strain on local governments.

To address these concerns about fairness, some loan modification programs reach out to borrowers who are struggling to make payments but are not yet delinquent on their mortgage. Most programs also specifically exclude individuals who provided false information in order to obtain a mortgage.

## **Incentives**

Another challenge is that loan modification programs may provide an incentive for borrowers to intentionally miss payments or default on their mortgage in order to qualify for a loan

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<sup>46</sup> Remarks by FDIC Chairman Sheila Bair to the New America Foundation conference “Did Low-Income Home Ownership Go Too Far?”: Washington, D.C., December 17, 2008. A transcript of these remarks is available at <http://www.fdic.gov/news/news/speeches/archives/2008/chairman/spdec1708.html>.

<sup>47</sup> Office of the Comptroller of the Currency and Office of Thrift Supervision, “OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009,” June 30, 2009, p. 32, available at <http://files.ots.treas.gov/4820471.pdf>.

modification that provides more favorable mortgage terms. While many of the programs described above, including Hope for Homeowners, specifically require that a borrower must not have intentionally missed payments on his or her mortgage in order to qualify for the program, it can be difficult to prove a person's intention. Programs that are designed to reach out to distressed borrowers before they miss any payments, as well as those who are already delinquent, may minimize the incentive for homeowners to intentionally fall behind on their mortgages in order to receive help.

## **Precedent**

Some opponents of government efforts to provide or encourage loan modifications argue that changing the terms of a contract retroactively sets a troubling precedent for future mortgage lending. These opponents argue that if lenders believe that they could be forced to change the terms of a mortgage in the future, they will be less likely to provide mortgage loans in the first place or will only do so at higher interest rates to counter the perceived increase in the risk of not being repaid in full. Most existing programs attempt to address this concern by limiting the program's scope. Often, these programs apply only to mortgages that originated during a certain time frame, and end at a pre-determined date.



## Appendix. Comparison of Recent Federal Foreclosure Prevention Initiatives

Table A-1. Features of Selected Programs

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
Making Home Affordable: Home Affordable Modification Program (HAMP)	<p>Borrower has a mortgage held by any participating lender or servicer</p> <p>Borrower is experiencing a financial hardship leading to difficulty making mortgage payments or is already delinquent</p> <p>Borrower occupies home as his/her primary residence</p> <p>Mortgage originated on or before January 1, 2009</p> <p>Unpaid principal balance is no higher than \$729,750 for a one-unit property (this is the Fannie Mae/Freddie Mac conforming loan limit for high cost areas; higher limits apply for two- to four-unit properties)</p>	<p>Lenders and servicers will contact eligible borrowers, but borrowers are encouraged to contact their servicers as well</p> <p>Servicer modifies mortgage to achieve 38% DTI, primarily using interest rate reduction</p> <p>Government matches further reductions to achieve 31% DTI</p> <p>Government will make incentive payments to servicers for making modifications, and to both borrowers (in the form of principal reduction) and servicers if the borrower remains current on the new loan</p>	<p>Announced February 18, 2009</p> <p>Program began on March 4, 2009</p> <p>Estimated to be able to help between 3 and 4 million homeowners</p> <p>As of November 26, 2009, over 697,000 active trial modifications and over 31,300 active permanent modifications were underway</p>

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
HOPE for Homeowners	<p>Borrower has a non-FHA mortgage and lender agrees to participate</p> <p>Borrower is at risk of default or foreclosure</p> <p>Borrower occupies home as his/her primary residence</p> <p>Borrower has experienced financial hardship and has total monthly mortgage payments higher than 31% of gross monthly income</p> <p>Mortgage originated on or before January 1, 2008, and at least 6 payments have been made</p> <p>Borrower does not have a fraud conviction in the last 10 years, has not intentionally defaulted, and did not provide false information to obtain original mortgage</p>	<p>Borrower contacts lender to determine eligibility</p> <p>Borrower refinances into FHA-insured fixed rate mortgage for no more than 96.5% of home's currently appraised value (mortgage may not exceed \$550,440)</p> <p>Lender absorbs loss resulting from write-down in mortgage value</p> <p>Borrower shares equity in home with FHA when the home is sold</p> <p>Borrower pays up-front and annual mortgage insurance premiums</p> <p>Second lien-holders release their liens in exchange for an upfront payment</p>	<p>Active; began October 1, 2008, and slated to expire September 30, 2011</p> <p>As of July 16, 2009, 949 applications had been received and 50 loans had closed out of about 400,000 homeowners that were originally estimated could be served</p>
FDIC IndyMac modificatons	<p>Borrower has a loan owned or serviced by IndyMac</p> <p>Borrower is (1) seriously delinquent or in danger of default, or (2) having trouble making mortgage payments due to interest rate resets or changes in financial circumstances</p> <p>Borrower occupies home as his/her primary residence</p> <p>Borrower provides current income information documenting financial hardship</p> <p>Loan modification meets "net present value test," meaning that the loan modification must be less costly for FDIC than foreclosure</p>	<p>FDIC contacts eligible borrowers, but also encourages troubled homeowners to contact FDIC or IndyMac to see if they qualify</p> <p>Mortgages are systematically modified to achieve monthly payments of no more than 38% of borrowers' monthly income</p> <p>Achieves 38% mortgage debt-to-income ratio by a combination of lowering the interest rate, extending the loan term, or forbearing part of the principal</p>	<p>Active; announced July 11, 2008</p> <p>Served about 13,000 homeowners while under FDIC conservatorship; program expected to continue under IndyMac's new owner, OneWest Bank</p>

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
<i>FHASecure</i>	<p>Borrower had a non-FHA ARM</p> <p>Borrower was delinquent due to an interest rate reset or other extenuating circumstances</p> <p>Borrower occupied home as his/her primary residence</p> <p>Borrower had sufficient income to pay new loan</p> <p>Borrower missed no more than a minimum number of payments prior to reset or onset of extenuating circumstances (or had sufficient equity in the home)</p>	<p>Borrower contacted lender to determine eligibility</p> <p>Borrower refinanced into new, fixed-rate, FHA-insured mortgage</p> <p>Borrower's new loan met standard FHA underwriting criteria</p> <p>Borrower met other standard FHA requirements, such as paying FHA insurance premiums</p>	<p>Announced August 31, 2007. Expired Dec. 31, 2008</p> <p>Estimated to have served about 4,000 homeowners</p>
Fannie Mae and Freddie Mac Streamlined Modification Plan	<p>Borrower had a loan owned by Fannie Mae or Freddie Mac</p> <p>Borrower had missed three or more monthly payments</p> <p>Borrower occupied home as his/her primary residence</p> <p>Mortgage loan-to-value ratio was at least 90%</p> <p>Mortgage originated on or before January 1, 2008</p> <p>Borrower was not in active bankruptcy</p>	<p>Borrower contacted lender to determine eligibility</p> <p>Mortgages were systematically modified to achieve 38% mortgage debt-to-income ratio</p> <p>Modification followed the following steps, in order, as necessary to achieve 38% DTI: (1) capitalize late payments and accrued interest; (2) extend loan term for up to four years from modification date; (3) adjust interest rate to no lower than 3%; (4) principal forbearance.</p> <p>Servicers received payment for each modification completed</p>	<p>Began December 15, 2008. Replaced by Making Home Affordable in March 2009</p> <p>Fannie and Freddie completed 51,115 loan modifications between January 2009 and April 2009; however, it is unclear how many of these modifications are attributable to the SMP</p>

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<b>Program/Initiative</b>	<b>Basic Eligibility Requirements</b>	<b>Program Details</b>	<b>Status</b>
Federal Reserve Homeownership Preservation Policy	<p>Borrower has a loan held, owned, or controlled by a Federal Reserve Bank</p> <p>Borrower is at least 60 days delinquent, or is experiencing circumstances making it likely that he or she will become 60 days delinquent</p> <p>Loan modification meets “net present value test,” meaning that the loan modification must be less costly for the Fed than foreclosure</p> <p>Reasonable likelihood that borrower can repay new loan</p>	<p>Fed contacts eligible borrowers</p> <p>Mortgages are modified to achieve a DTI of no more than 38% using interest rate reductions, loan term extensions, principal forbearance, principal forgiveness, or other changes to loan terms</p> <p>Modified loan has a fixed interest rate and loan term of no more than 40 years</p>	Announced January 27, 2009

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**Source:** Table created by CRS.

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