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Committee on Oversight and Government Reform

Darrell Issa (CA-49), Ranking Member, Full Committee
Jim Jordan (OH-4), Ranking Member, Domestic Policy Subcommittee

Treasury Department's Mortgage Modification Programs: A Failure Prolonging the Economic Crisis

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INTRODUCTION

This report by the Committee on Oversight and Government Reform Republican Staff tracks the history of the Obama Administration's foreclosure mitigation programs, focusing on the Home Affordable Modification Program (HAMP), the most active and highest-profile of those programs. HAMP is a $75 billion taxpayer-funded program that incentivizes mortgage companies to lower mortgage payments and renegotiate rates for homeowners facing foreclosure. In return, The U.S. Department of the Treasury subsidizes the modifications through direct payments to servicers, lenders, and borrowers.

These federally-imposed mortgage modifications are a questionable use of taxpayer resources and they have failed to have a significant effect on rising foreclosure rates. HAMP's failure to assist anywhere near the 3-4 million distressed homeowners to whom the Administration promised aid demonstrates that technocratic tinkering is not an effective way to solve economic problems. The only viable long-term solution to falling housing prices and rising foreclosures is a broad-based economic recovery.

In its current form, HAMP both hurts homeowners who might otherwise spend their trial-period mortgage payments on rent and also distorts the housing market, delaying any recovery. Treasury owes American taxpayers and homeowners an honest explanation of HAMP's ill-advised creation and ongoing mismanagement.

EXECUTIVE SUMMARY

HAMP has failed. By every empirical measure, HAMP has failed. In March 2009, the Administration promised it would "help up to 3 to 4 million homeowners avoid foreclosure." As recently as November 2009, Treasury suggested that HAMP would permanently modify mortgages for 375,000 borrowers by the end of the year. But at the end of January 2010, the program had produced only about 116,000 permanent modifications – despite pressure from the Obama Administration on mortgage companies. Meanwhile, a record proportion of U.S. mortgages are now in foreclosure.[1]

HAMP may actually hurt more homeowners than it helps. HAMP grants a trial modification while the homeowner's paperwork is being examined. After the homeowner's eligibility has been confirmed – so long as mortgage payments have continued uninterrupted – the program grants a permanent modification. Treasury's own data suggests that hundreds of thousands of homeowners would receive temporary modifications but fail to qualify for permanent ones, thus ultimately leading to default. These homeowners would have been better off if they had defaulted earlier and spent the payments on more affordable housing options.

[1] Julie Haviv, "Mortgages foreclosing, delinquent at 16 percent in Q4," *Washington Post*, Feb. 19, 2010.

Treasury is trying to hide the failure of HAMP. Despite repeated promises of transparency, Treasury has tried to cover up HAMP's failure. For example, Treasury stopped reporting a key number in January 2010, a move that effectively prohibited government watchdog groups and news organizations from calculating and reporting HAMP's success rate to the public.

THE OBAMA ADMINISTRATION'S FORECLOSURE MITIGATION PROGRAMS

Between February and March of 2009, Treasury unveiled its Making Home Affordable (MHA) initiative,[2] the "Federal government's central tool to combat foreclosures."[3] MHA has two primary components: the Home Affordable Refinance Program (HARP) and the Home Affordable Modification Program (HAMP). Treasury Secretary Timothy Geithner promised that the programs would observe "new, higher standards for transparency and accountability."[4] Geithner said, "Government support must come with strong conditions to protect the taxpayer and with transparency that allows the American people to see the impact of their investments."[5]

HARP is a refinancing program for existing mortgages that are owned or guaranteed by Fannie Mae and Freddie Mac, two government securitized entities (GSE) under federal conservatorship since 2008. GSEs typically are barred from purchasing mortgages with loan-to-value ratios above 80 percent without private mortgage insurance coverage.[6] Under HARP, Fannie and Freddie allow eligible borrowers to refinance mortgages with principal balances up to 125 percent of current value.[7] To qualify, homeowners must have been current on their mortgage payments for the past year. HARP refinancings must either decrease the borrower's monthly mortgage payment or move the borrower to "a more stable mortgage product."[8] The refinancings are limited to first mortgages. The government does not directly subsidize HARP refinancings; instead, the program's fiscal impact is on the GSEs' balance sheets.[9] Treasury originally predicted that HARP would be available to "4 to 5 million homeowners."[10]

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[2] Treasury Department Press Release, "Homeowner Affordability and Stability Plan," Feb. 18, 2009, *available at* **http://www.financialstability.gov/latest/tg33.html**.

[3] Congressional Oversight Panel, *October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months*, Oct. 9, 2009 ("Oversight Report"), *available at* **http://cop.senate.gov/documents/cop-100909-report.pdf**.

[4] Treasury Department Press Release, "Secretary Geithner Introduces Financial Stability Plan," Feb. 10, 2009, *available at* **http://www.ustreas.gov/press/releases/tg18.htm**.

[5] *Id.*

[6] Oversight Report at 42.

[7] Making Home Affordable Frequently Asked Questions, July 16, 2009 (hereinafter "MHA FAQ"). HARP originally was limited to mortgages with principals up to 105 percent of current market value; on July 1, 2009, Treasury raised the limit to 125 percent.

[8] Oversight Report at 41.

[9] Since the GSEs are in Federal conservatorship, however, their activities will have an eventual impact on the Federal budget.

[10] *See* Summary Guidelines.

HAMP includes four sub-programs: (a) a first-lien modification program, (b) a second-lien modification program, (c) the Home Price Decline Protection (HPDP) program, and (d) the Home Affordable Foreclosure Alternatives Program (HAFA). HAMP's first-lien mortgage modification program was the first announced, has the highest profile, and is described throughout this memorandum. Treasury has offered scant public disclosure about the other sub-programs, and they appear to have had very little effect.[11]

HARP and HAMP join two pre-existing federal foreclosure mitigation programs, HOPE for Homeowners and the FDIC's Loan Modification Program. HOPE for Homeowners, part of the Housing and Economic Recovery Act (HERA) of 2008, permits borrowers to refinance into a Federal Housing Administration (FHA) loan, requires lenders to write down the principle to 90 percent of the value of the property, and requires borrowers to share any future equity appreciation with the FHA. Though originally projected to help 400,000 homeowners, HOPE for Homeowners had only closed 96 loans as of January 2010, despite vague promises by the FHA that the program would be expanded.[12] Finally, the FDIC has established a loan modification program that is a mandatory component of its 55 mortgage loss-sharing agreements with purchasers of failed banks' assets. The program is similar to HAMP's first-lien modification program. The FDIC has not yet submitted data on the number of loans modified under its program.

On February 19, 2010, during a campaign appearance in hard-hit Nevada with Senator Harry Reid (D-NV), President Obama announced that $1.5 billion in Recovery Act funds would be allocated to state housing agencies[13] in five states: Nevada, California, Michigan, Florida, and Arizona.[14] The state agencies would be permitted to use the funds for (1) programs assisting unemployed borrowers, (2) programs assisting borrowers owing more than the value of their homes, (3) programs incentivizing the modification of second liens, and (4) "other programs encouraging sustainable and affordable housing."

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[11] Treasury first announced the eligibility, underwriting, and servicing requirements for the second-lien modification program on August 13, 2009. *See* Treasury Department, Supplemental Directive 09-05, "Introduction of the Second Lien Modification Program," Aug. 13, 2009, *available at* **https://www.hmpadmin.com/portal/docs/second_lien/sd0905.pdf**. But no mortgage servicer joined the program until Bank of America did so on January 26, 2010. *See* Bank of America Press Release, "Bank of America Becomes First Mortgage Servicer to Sign Contract for Home Affordable Second-Lien Modification Program, Jan. 26, 2010, *available at* **http://newsroom.bankofamerica.com/index.php?s=43&item=8624**. Treasury has not reported that any second mortgages has been modified under the second-lien program. Meanwhile, Treasury has not publicly disclosed any activity in the Home Price Decline Protection (HPDP) program, which is intended to pay additional incentives to investors who own HAMP-eligible mortgages to permit those loans to be modified. HAFA, which provides incentives to servicers and borrowers who utilize a short sale or a deed-in-lieu to avoid a foreclosure on a HAMP-eligible loan, will not begin on a mandatory basis until April 5, 2010. *See* Treasury Department, Supplemental Directive 09-09, "Introduction of Home Affordable Foreclosure Alternatives – Short Sale and Deed-in-Lieu of Foreclosure, Nov, 30, 2009, *available at* **https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0909.pdf**.

[12] Dawn Kopecki and Theo Francis, "U.S. May Retool Loan Program for Underwater Borrowers," *Business Week*, Jan. 27, 2010.

[13] White House Press Release, "President Obama Announces Help for Hardest Hit Housing Markets," Feb. 19, 2010, *available at* **http://www.whitehouse.gov/the-press-office/president-obama-announces-help-hardest-hit-housing-markets** ("February 2010 Announcement").

[14] Kate Anderson Brower, "Obama Announces $1.5 Billion in Aid for Homeowners," *Business Week*, Feb. 19, 2010.

HAMP'S FIRST-LIEN MODIFICATION PROGRAM: $75 BILLION TO SUBSIDIZE MORTGAGE MODIFICATIONS

HAMP's first-lien modification program (for simplicity, referred to hereinafter simply as HAMP) is the $75 billion centerpiece of the Federal government's foreclosure mitigation efforts. It is funded with $50 billion from TARP, which will subsidize the modification of privately-owned mortgages, and $25 billion from HERA, which will subsidize the modification of mortgages owned by Fannie and Freddie. Although it describes TARP as an "investment," Treasury admits that the $50 billion in TARP funds allocated for HAMP will not be returned; HAMP's intent is to subsidize, not to invest.[15]

Under HAMP, participating mortgage servicers sign contracts with Fannie Mae, Treasury's designated financial agent, agreeing to grant mortgage modifications to borrowers under prescribed circumstances. In return, Treasury subsidizes the modifications through direct payments to servicers, lenders, and borrowers. Treasury initially promised that HAMP would "help up to 3 to 4 million at-risk homeowners avoid foreclosure by reducing monthly mortgage payments."[16]

Participation in HAMP is mostly voluntary,[17] but most major servicers have signed up.[18] As of January 2010, 108 servicers had executed Participation Agreements.[19] Together with Fannie Mae and Freddie Mac, the participating servicers account for all but about 600,000 of the nation's HAMP-eligible delinquencies.[20] Treasury intends to dominate the market: it announced that HAMP's mandatory mortgage modification process will become "standard industry practice,"[21] replacing mortgage servicers' individualized business practices.

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[15] *See* Office of the Special Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress, Oct. 21, 2009 (hereinafter "SIGTARP Report"), *available at* **http://www.sigtarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf**, at 39.

[16] *See* Summary Guidelines.

[17] Participation is mandatory for servicers of Fannie Mae or Freddie Mac mortgages and for participants in TARP programs initiated after February 9, 2009. Since the Capital Purchase Program (CPP), the primary TARP vehicle for bank assistance, was established before that date, the TARP participation requirement does not apply to most financial institutions.

[18] *See* MHA FAQ. The Majority Memorandum suggests that HAMP's ineffectiveness may be due in part to the fact that the program is "voluntary." But participating servicers – who represent a large majority of the nation's mortgage debt – are bound by their contracts with Fannie Mae to offer mortgage modifications.

[19] Treasury Department, Making Home Affordable Program Servicer Performance Report Through January 2010, Feb. 18, 2010, *available at* **http://www.financialstability.gov/docs/press/January%20Report%20FINAL%2002%2016%2010.pdf** ("January Servicer Report").

[20] Renae Merle, "Administration Pushed to Expand Foreclosure-Prevention Program," *Washington Post*, Feb. 18, 2010.

[21] *See* Summary Guidelines.

HAMP'S ONE-SIZE-FITS-ALL MORTGAGE MODIFICATION PROCESS

Under HAMP, Treasury codified a one-size-fits-all mortgage modification process that obligates participating servicers to grant subsidized modifications to borrowers under certain circumstances. For *every* eligible borrower whose loan passes Treasury's secret net present value test, payments are reduced to 31% of income, regardless of other circumstances.

Under HAMP, borrowers apply to their servicers to request modifications. Only first-lien mortgages that were originated before January 1, 2009, have principal balances beneath prescribed limits, and are in default or at risk of imminent default[22] are eligible. A borrower must demonstrate a monthly mortgage payment that exceeds 31 percent of monthly gross income and that the payment is not affordable due to a financial hardship.[23]

Servicers are required to use a net present value (NPV) test on each mortgage. The test compares the NPV of expected cash flows with and without modification. If the NPV is greater under the modification scenario, the servicer *must* offer to modify the loan.[24] The NPV test, which is described in more detail below, uses a secret calculation model that Treasury has refused to publish.

Treasury has chosen to reduce all monthly payments to 31 percent of the borrower's gross income. In every HAMP modification, the lender first reduces the payment to 38 percent of income, then Treasury and the lender share the burden of reducing the payment to 31 percent. Treasury will not share the burden of reductions that push the resulting interest rate below 2 percent. If a payment reduced to an interest rate of 2 percent is still above 31 percent of the borrower's gross monthly income, the servicer must extend the payment term and/or defer a portion of the principal. Servicers may, but are not required to, forgive a portion of the principal.[25]

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[22] The Oversight Report noted that servicers had reported a lack of quality around the definition of "imminent default." *See* Oversight Report n. 124. On January 22, 2010, the Department of Housing and Urban Development announced a definition for "imminent default" that would apply to borrowers with FHA-insured loans (but not officially to other borrowers):

> FHA defines an "FHA borrower facing imminent default" to be an FHA borrower who is current or less than 30 days past due on the mortgage obligation and is experiencing a significant reduction in income or some other hardship that will prevent him or her from making the next required payment on the mortgage during the month that it is due.

Housing and Urban Development Press Release, "FHA to Provide Early Relief to Struggling Homeowners," Jan. 22, 2010, *available at* **http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-017**.

[23] *See* MHA FAQ.

[24] *See* Summary Guidelines.

[25] *See* MHA FAQ.

HAMP modifications begin with a three-month trial period. If the borrower successfully makes all payments during the trial period, and the servicer is able to verify that the borrower's income and expense information is correct, then the servicer and the borrower execute a permanent modification agreement. Under the modification agreement, the interest rate is fixed for five years, but then rises by a maximum of one percentage point per year until it reaches the market rate at the time of the original modification.[26]

Treasury subsidizes HAMP modifications by (a) sharing the cost of reductions in monthly payments; (b) making direct incentive payments to the servicers of $1,000 for each loan modification, then $1,000 annually in a "pay for success" fee for each loan that continues to perform; (c) contributing up to $1,000 annually to reduce the principal for homeowners who make their payments on time; and (d) providing "bonus incentives" of $1,500 to the lender/investor and $500 to the servicer for each modification made while the borrower is still current on payments.[27]

HAMP-modified loans are a new phenomenon in the mortgage market and are not yet fully understood by either the industry or the government. Ironically, HAMP-modified loans are most closely comparable to subprime mortgage loans, and particularly hybrid-adjustable-rate mortgages (hybrid-ARMS). Like hybrid-ARMs, HAMP-modified loans feature initial below-market rates that last for a multi-year period, then adjust to higher rates. Like hybrid-ARMs, HAMP-modified loans are originated based on the borrower's ability to afford the initial rate, rather than the higher, post-adjustment rate.[28] In other words, as noted by the National Fair Housing Alliance at a Congressional Oversight Panel (COP) field hearing, "We don't have really permanent modifications . . . we have five year modifications …."[29]

HAMP'S SECRET NET PRESENT VALUE CALCULATION MODEL

Under HAMP, a servicer must grant a modification if the application meets certain criteria and if the loan passes Treasury's mandatory net present value (NPV) test. Under the test, the servicer first determines the NPV of the proceeds from the liquidation and sale of a mortgaged property. Second, the servicer determines the NPV of expected proceeds if the modification is granted. This calculation takes into account the reduction in monthly payments, an expected redefault rate, and other variables. If the NPV under the modification scenario is greater than the NPV under the foreclosure scenario, then the servicer must offer to modify the loan.

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[26] *See* MHA FAQ.

[27] *See* Summary Guidelines.

[28] Oversight Report at 99-100.

[29] Deborah Goldberg, *Philadelphia Field Hearing on Mortgage Foreclosures*, (Sept. 24, 2009), at 85. The Congressional Oversight Panel is charged under the Emergency Economic Stabilization Act of 2008 with overseeing the government's foreclosure mitigation efforts. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, sec. 125(b)(1) of Title 1.

Treasury requires servicers to use its proprietary mathematical model for the NPV test. Other government entities that require such calculations for various purposes – including the OCC, the OTS, and the FDIC – publish their NPV models, but Treasury does not.[30] Treasury has justified keeping its model secret by suggesting that secrecy will prevent borrowers from "gaming" the system.[31]

The COP was permitted to examine Treasury's NPV model. The COP found the model to be "highly sensitive to small changes in certain parameters as well as quite inflexible in other regards."[32] Because secrecy prevents borrowers from understanding the "specific reason for denying a modification and a clear path for appeal," the COP recommended that Treasury release the model.[33]

Moreover, the NPV test does not take into account what the Boston Federal Reserve has called the "self-cure risk," *i.e.*, the risk that a delinquent borrower would have been able to bring a mortgage loan current even without modification, thus rendering the expenses of the modification unnecessary.[34] Treasury's decision to impose its secret NPV model on the entire mortgage industry, and its goal of making that model an "industry standard" through HAMP, is likely to have unintended consequences.

HAMP'S DISAPPOINTING EARLY RESULTS AND THE ADMINISTRATION'S COERCIVE PRESSURE

In order to fulfill their new roles as Treasury-sponsored mortgage modification agencies, participating servicers created new business units, hired thousands of loan counselors, and opened new offices to promote HAMP and other programs. But the number of mortgages modified under HAMP disappointed the Administration. In particular, the number of trial modifications that successfully transitioned to permanent status remained extremely low throughout 2009.

By July 2009, participating financial institutions had offered borrowers approximately 270,000 trial modifications – a number inferior to the Administration's expectations.[35] To impose pressure on the servicers, Treasury Secretary Timothy Geithner and Housing and Urban Development Secretary Shaun Donovan responded by sending a letter scolding participating servicers. "We believe there is a general need for servicers to devote substantially more resources to this program for it to fully succeed and achieve the objectives we all share," Geithner and Donovan wrote.[36] They instructed participating servicers to expand their HAMP staffs, improve call center capacity, and better train

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[30] *See* Oversight Report at 48.

[31] *See id.*

[32] *See* Oversight Report at annex C.

[33] *See* Oversight Report at 6.

[34] *See infra* for a summary of the Boston Fed's analysis.

[35] Renae Merle, "White House Prods Banks: Letter Tells Chiefs to Start Backing Mortgage Relief," *Washington Post*, July 10, 2009.

[36] *Id.*

employees to navigate the complex procedures. The letter also commanded the servicers to designate a senior liaison for HAMP and to send their executives to a July 2009 Washington meeting with Treasury and HUD officials. Mortgage servicers responded to the letter by issuing statements describing their efforts and voicing their support for HAMP.[37]

On July 29, 2009, Treasury reported that its meeting with servicers' executives had successfully improved the servicers' enthusiasm: "Servicers in attendance committed to significantly increasing the rate at which they are performing loan modifications." Treasury also reported that it would begin publicly releasing server-specific modification data; set customer-service metrics; and develop a "second look" process, in which Freddie Mac, "in its role as compliance agent," would audit samples of denied modification applications. [38] Treasury also began releasing monthly reports publicizing HAMP modification activity by servicer. The reports track each servicer's eligible delinquent loans (estimated), trial modification offers made to borrowers, and active trial and permanent modifications.[39]

As a result of the Administration's pressure, servicers redoubled their efforts to place borrowers in trial modifications, but a new problem developed: very few trial modifications became permanent. On October 9, 2009, the COP reported that HAMP mortgage modifications continued to underperform the Administration's predictions.[40] As of September 1, 2009, participating servicers had placed 362,348 borrowers in trial modifications, but only 1,711 trial modifications had become permanent.[41]

Research by Oversight Committee Minority staff suggests that some servicers, as a result of the Administration's pressure, placed borrowers in trial modifications without requiring any written proof of their income and debt levels.[42] Many borrowers then failed to provide proper verification after entering trial modifications.

Treasury responded to criticism of HAMP's disappointing results – particularly the extremely low rate of permanent modifications – by announcing a "conversion drive" on November 30, 2009.[43] Additional pressure, Treasury announced, would be put on

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[37] *Id.*

[38] Treasury Department Press Release, "Administration, Servicers Commit to Faster Relief for Struggling Homeowners through Loan Modifications," July 29, 2009, *available at* **http://www.financialstability.gov/latest/07282009.html**.

[39] *See, e.g.*, October Servicer Report.

[40] Oversight Report at *passim.*

[41] Oversight Report at 48. The Panel also found the results of other foreclosure mitigation programs to be disappointing: for example, only 95,729 HARP refinancings had been approved – 2 percent of the four to five million homeowners Treasury had originally estimated would be eligible. Oversight Report at 42.

[42] Freddie Mac Senior Vice President Edward Golding admitted to the Congressional Oversight Panel that Treasury permits servicers to grant "no-doc" trial modifications, in which the servicer starts a trial modification based on the borrower's verbal representations about their financial details. *See* Testimony of Michael D. Dudley, Sr. before the Domestic Policy Subcommittee of the House Committee on Oversight and Government Reform, Cleveland, Ohio, Dec. 7, 2009. Information provided to Oversight Committee staff confirms that servicers have been doing exactly that – and then finding that borrowers are unable or unwilling to provide documentation.

[43] Treasury Department, Press Release, "Obama administration [sic] Kicks Off Mortgage Modification Conversion

servicers to convert trial modifications to permanent ones. Servicers would be required to report to the Administration on a daily basis, and Treasury and Fannie Mae staffers would be assigned to serve as "account liaisons" on-site at the servicers' offices. In an interview with *The New York Times*, Assistant Treasury Secretary for Financial Institutions Michael Barr further criticized the servicers: "The banks are not doing a good enough job …. Some of the firms ought to be embarrassed, and they will be."[44] Treasury promised, "Roughly 375,000 of the borrowers who have begun trial modifications since the start of the program are scheduled to convert to permanent modifications by the end of the year."[45]

The conversion drive fell far short of Treasury's projections. At the end of December 2009, 66,465 modifications had become permanent.[46] On December 23, 2009, Treasury ratcheted up the pressure again by forbidding servicers to cancel a trial modification "for any reason other than failure to meet the HAMP property eligibility requirements."[47] This "review period" – during which servicers had to maintain most trial modifications, even if borrowers stopped payments, failed to properly document their income or debts, or reported income or debt that made them ineligible – lasted from December 23, 2009, to January 31, 2010.

The Administration's pressure, and the servicers' redoubled efforts, have not alleviated the foreclosure crisis. Foreclosures rose throughout 2009.[48] Bloomberg's Foreclosure Index rose throughout 2009 and is at a record high.[49] On February 19, 2010, the mortgage industry released data showing that a record proportion of U.S. mortgages were in foreclosure.[50]

Drive," Nov. 30, 2009, *available at* **http://www.treasury.gov/press/releases/tg421.htm** ("Conversion Drive Announcement").

[44] Peter Goodman, "U.S. Will Push Mortgage Firms to Reduce More Loan Payments," *The New York Times*, (Nov. 29, 2009), *available at* **http://www.nytimes.com/2009/11/29/business/economy/29modify.htm**.

[45] Conversion Drive Announcement, Nov. 30, 2009.

[46] Treasury Department, Making Home Affordable Program Servicer Performance Report Through December 2009, Jan. 19, 2010, *available at* **http://www.financialstability.gov/docs/report.pdf** ("December Servicer Report").

[47] *See* Treasury Department Press Release, "Administration Updates Documentation Collection Process and Releases Guidance to Expedite Permanent Modifications," Jan. 28, 2010, *available at* **http://www.financialstability.gov/latest/pr_01282010.html**.

[48] *See* Office of the Comptroller of the Currency and Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report, Third Quarter 2009 (issued Dec. 2009), *available at* **http://files.ots.treas.gov/482114.pdf**, at Table 6 (reporting that foreclosures and other home forfeiture actions in the third quarter of 2009 increased by 13.9% over the previous quarter and 6% over the same quarter in 2008).

[49] *See* Jonathan Hoenig, "The Plan to Stop Foreclosures Has Failed," *Wall Street Journal Smartmoney.com*, Feb. 18, 2010, *available at* **http://www.smartmoney.com/Investing/Economy/The-Plan-to-Stop-Foreclosures-Has-Failed/?hpadref=1** (reporting Bloomberg Foreclosure Index had hit new high at 11.74%).

[50] Julie Haviv, "Mortgages foreclosing, delinquent at 16 percent in Q4," *Washington Post*, Feb. 19, 2010.

HAMP FAILURE TRIGGERS BIPARTISAN CRITICISM; TREASURY HIDES CRUCIAL NUMBERS

HAMP has failed. Treasury's most recent servicer performance report discloses about 116,000 permanent modifications at the end of January 2010[51] – less than one-third the number Treasury projected in November, and less than one-thirtieth the number the Administration promised when it announced the program. The media reported widespread disappointment among lawmakers in both parties and housing advocates.[52]

Treasury has responded to criticisms of HAMP by making it harder to track the program's failure. In every servicer performance report through November 2009, Treasury disclosed the cumulative number of borrowers who had applied for mortgage modifications. This number could be compared to the number of permanent modifications to determine HAMP's overall success rate. Many news organizations did so, and their calculations, as of November 2009, showed that only about 1% of borrowers who sought help from HAMP had achieved permanent modifications.[53] In its December 2009 report, Treasury stopped disclosing the number of applicants, making the success rate impossible to calculate.[54] On February 4, 2010, Ranking Member Darrell Issa (R-CA) and Domestic Policy Subcommittee Ranking Member Jim Jordan (R-OH) sent a letter to Treasury Secretary Timothy Geithner requesting that Treasury reinstate the crucial metric. At this writing, Mr. Issa and Mr. Jordan have not received a response from Treasury.

Treasury has also used HAMP statistics in misleading ways. For instance, in November 2009 it announced that HAMP had "helped over 650,000 borrowers,"[55] obscuring the difference between temporary and permanent modifications.

Oversight Committee Democrats have lost patience with Treasury over its handling of HAMP. On January 11, 2010, Domestic Policy Subcommittee Chairman Dennis Kucinich (D-OH), in a letter to Secretary Geithner, criticized Treasury's determination "to insist on an optimistic view of HAMP's performance."[56] Mr. Kucinich did not find the testimony representations of Treasury officials to be credible, and therefore submitted extensive written questions seeking hard numbers describing the performance of HAMP.

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[51] January Servicer Report.

[52] *See, e.g.*, Renae Merle, "Administration pushed to expand foreclosure-prevention program," *Washington Post*, Feb. 18, 2010; Dawn Kopecki and Theo Francis, "U.S. May Retool Loan Program for Underwater Borrowers," *Business Week*, Jan. 27, 2010; Shahien Nasiripour, "Obama Foreclosure Program Shows Slight Gains, Though Troubling Trends Remain," *Huffington Post*, Feb. 18, 2010, *available at* http://www.huffingtonpost.com/2010/02/18/obama-foreclosure-program_n_466676.html (quoting industry analyst: "I don't think [HAMP] is going to stop the large numbers of foreclosures coming onto the market in the next few quarters … [HAMP] has been helpful on the margins in the sense that something is better than nothing").

[53] *See, e.g.*, Daniel Indiviglio, "1% Success Rate for Obama Administration Mortgage Modification Program," *The AtlanticBusiness Channel*, Dec. 11, 2009, *available at* **http://business.theatlantic.com/2009/12/1_success_rate_for_obama_administration_mortgage_modification_program.php**.

[54] December Servicer Report.

[55] Conversion Drive Announcement, Nov. 30, 2009.

[56] Letter from Dennis Kucinich to Timothy Geithner, Jan. 11, 2010.

As of this writing, Mr. Kucinich had not received a response from Treasury. Chairman Edolphus Towns joined Kucinich's criticisms on February 4, 2010, when he requested a voluntary production of documents from Treasury to assist the Committee's investigation of HAMP's failure.[57] As of this writing, Chairman Towns has not received documents from Treasury.

EXPLAINING HAMP'S POOR RESULTS

Research by former Fannie Mae Chief Credit Officer Edward Pinto suggests that the Administration will fall far short of its goal of modifying the loans of three to four million borrowers.[58] Of the 50,000 trial modifications in progress as of May 31, 2009, only about 2.5% had entered permanent status four months later.[59] Informed estimates suggest that half or fewer of the current 500,000 borrowers on trial modifications will successfully submit the required documentation and prove to be qualified.[60] Moreover, slightly more than half of qualified borrowers are expected to either fail to make all payments during their trial period or re-default after permanent modification.[61] At these success rates, the Administration would need to put 12 to 22 million loans into trial modifications in order to prevent 3 to 4 million foreclosures. Since it can be expected that "prime candidates" for modifications will get them first,[62] the Administration's goal appears mathematically impossible.

The COP pointed out that HAMP, like the Federal government's other mortgage mitigation programs, was "designed to address the foreclosure crisis as it was understood in early 2009."[63] HAMP was designed to assist homeowners whose payments have increased – perhaps due to rate resets on exotic mortgage products – but who are still employed and able to make payments. However, 31 percent of zero is still zero; HAMP cannot assist borrowers who are unemployed with no income.[64] In other words, since unemployment, instead of ballooning mortgage payments, is now driving foreclosures, HAMP modifications may not be available to most distressed borrowers.

Rising unemployment, however, does not fully explain HAMP's deplorable conversion rate from trial modifications to permanent modifications. The evidence suggests that

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[57] Letter from Edolphus Towns to Timothy Geithner, Feb. 4, 2010.

[58] *See* Joe Weisenthal, "Edward Pinto: The Government's Loan Modification Numbers Are A Total Sham," *The Business Insider: The Money Game*, Oct. 25, 2009, *available at* **http://www.businessinsider.com/edward-pinto-the-governments-loan-modification-numbers-are-a-total-sham-2009-10**.

[59] *See id.*

[60] *See id.*

[61] *See id.*

[62] *See* Oversight Report at 95.

[63] Oversight Report at 103.

[64] Unemployment benefits are counted as income for the purposes of HAMP calculations. *See, e.g.,* Department of Labor, Press Release, "DOL Tool Projects UI Income to Modify Home Loans," Oct. 23, 2009 (reporting collaborative effort between Labor, Treasury, Fannie Mae, Freddie Mac, Federal Reserve, and Hope Now Alliance to create unemployment benefit estimation tool to allow mortgage companies to project unemployment insurance benefits for loan modification purposes).

servicers have granted trial modifications to borrowers who do not qualify for them, based solely on the borrowers' verbal representations about their income and assets. Indeed, a Cleveland city council member testified at the Domestic Policy Subcommittee's December 7, 2009 field hearing that some borrowers were treating HAMP as a temporary solution, using trial modifications to stave off foreclosure for just a few months.[65]

On January 28, 2010, Treasury announced that it would now require servicers to obtain key documentation before starting trial modifications.[66]

BOSTON FED EXPLAINS WHY SERVICERS ARE RELUCTANT TO RENEGOTIATE MORTGAGES

On July 6, 2009, the Federal Reserve Bank of Boston published a paper entitled *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization*.[67] The paper noted that Federal anti-foreclosure efforts, notably Hope for Homeowners and HAMP, had focused on renegotiation:

> The appeal of renegotiation to policymakers is simple to understand. If a lender makes a concession to a borrower by, for example, reducing the principal balance on the loan, it can prevent a foreclosure. This is clearly a good outcome for the borrower, and possibly good for society as well. *But the key to the appeal of renegotiation is the belief that it can also benefit the lender*, as the lender loses money only if the reduction in the value of the loan exceeds the loss the lender would sustain in a foreclosure. In short, according to proponents, renegotiation of home mortgages is a type of public policy holy grail, in that it helps both borrowers and lenders at little or no cost to the government.[68]

If that logic were correct, the Boston Fed reasoned, "lenders should find renegotiation attractive, even in the absence of government prodding." But the Boston Fed's examination of a large sample of troubled residential mortgages[69] demonstrated that "lenders rarely negotiate …. Fewer than 3 percent of the seriously delinquent borrowers in our sample received a concessionary modification in the year following the first serious delinquency."[70]

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[65] *See* Testimony of Michael D. Dudley, Sr. before the Domestic Policy Subcommittee of the House Committee on Oversight and Government Reform, Cleveland, Ohio, Dec. 7, 2009.

[66] Treasury Department Press Release, "Administration Updates Documentation Collection Process and Releases Guidance to Expedite Permanent Modifications," Jan. 28, 2010, *available at* http://www.financialstability.gov/latest/pr_01282010.html.

[67] Manuel Adelino, Krisopher Gerardi, and Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization*, Federal Reserve Bank of Boston Public Policy Discussion Paper No. 09-4, *available at* **http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf** (hereinafter "Boston Fed Paper").

[68] Boston Fed Paper at 2.

[69] The Boston Fed used a dataset constructed by Lender Processing Services (LPS) that comprised approximately 60 percent of the U.S. mortgage market from the beginning of 2007 through the end of 2008 (though calculations were performed using samples, then confirmed using other samples, because of computational capacity).

[70] Boston Fed Paper at 3.

Why such a low renegotiation rate? The Boston Fed considered and rejected the hypothesis that widespread mortgage securitization is responsible for the phenomenon. Its empirical analysis found that the difference in renegotiation rates between loans owned by private securitization trusts and "portfolio" loans owned directly by servicers and not subject to securitization was not statistically significant.

Instead, the Boston Fed argued, low renegotiation rates are due to "a very mundane explanation: lenders expect to recover more from foreclosure than from a modified loan."

> The problem [with renegotiation, from a lender's standpoint] is that renegotiation exposes lenders to two types of risks that can dramatically increase its cost. The first is what we will call "self-cure" risk … [M]ore than 30 percent of seriously delinquent borrowers [in the Boston Fed's sample of troubled mortgages] "cure" [return their loan to current status] without receiving a modification; if taken at face value, this means that, in expectation, 30 percent of the money spent on a given modification is wasted. The second cost comes from borrowers who redefault; our results show that a large fraction of borrowers who receive modifications end up back in serious delinquency within six months. For them, the lender has simply postponed foreclosure; in a world with rapidly falling house prices, the lender will now recover even less in foreclosure.[71]

The Boston Fed noted that proponents of government-sponsored mortgage modification programs frequently take redefault risk into account, but ignore self-cure risk. It concluded, "[O]ne cannot evaluate a modification by simply comparing the reduction in the interest rate on the loan or in the principal balance with the expected loss in foreclosure."[72] The true costs and benefits of a modification must take into account the risk that the modification might prove to be either unnecessary (self-cure risk) or futile (redefault risk).

The COP admitted, "The economics of servicing are still not fully understood, and this presents a challenge for any attempt to craft an incentive-based modification program."[73] HAMP represents a very clumsy attempt to adjust the incentives facing servicers. Clearly, Treasury's origination incentive payment of $1,000 and annual payments of $1,000 for each modified loan are numbers pulled from a hat.

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[71] Boston Fed Paper at 7.

[72] *Id.*

[73] Oversight Report at 69.

HAMP FAILS TO HELP, AND MAY ACTUALLY HARM, THOUSANDS OF HOMEOWNERS

At the beginning of January 2010, the New York Times reported that some economists had begun to argue HAMP had "done more harm than good."[74] The Times article explained:

> Critics increasingly argue that the program … has raised false hopes among people who simply cannot afford their homes. As a result, desperate homeowners have sent payments to banks in often-futile efforts to keep their homes, which some see as wasting dollars they could have saved in preparation for moving to cheaper rental residences. Some borrowers have seen their credit tarnished while falsely assuming that loan modifications involved no negative reports to credit agencies.[75]

The Administration's one-size-fits-all approach to mortgage modification might exacerbate the danger of granting modifications to borrowers who will not benefit from them. For example, Treasury's secret NPV test takes into account an assumed redefault rate in comparing the expected cash flows of a modified and a non-modified mortgage.[76] "Changes in redefault rates," the COP pointed out, "will obviously affect the NPV calculus."[77] If the secret NPV test underestimates the redefault rate, servicers will grant too many futile modifications. In short, HAMP appears to be incentivizing behavior that is neither in servicers' interests, or, in the long term interests of borrowers who end up defaulting anyway.

Treasury's most recent servicer performance report suggests that a large number of the borrowers currently in trial modifications will fail to achieve permanent modifications and eventually default. As of the end of January 2010, 830,438 trial modifications were active, while 60,476 trial modifications had, so far, been canceled without maturing into permanent modifications.[78] This report coincided with the last day of Treasury's mandatory "review period;" between December 23, 2009, and January 31, 2010, servicers were banned from canceling most trial modifications for any reason except "failure to meet the HAMP property eligibility requirements."[79] Judging from previous reporting periods, it is reasonable to expect that a large proportion of the 830,438 active trial modifications did not qualify and were canceled after the "review period" expired.

Moreover, the economists quoted in the *Times* article also charged that HAMP might be prolonging the housing crisis and delaying the eventual recovery:

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[74] Peter Goodman, "U.S. Loan Effort is Seen as Adding to Housing Woes," *New York Times*, Jan. 1, 2010.

[75] *Id.*

[76] Oversight Report at 47.

[77] *Id.*

[78] January Servicer Report.

[79] *See* Treasury Department Press Release, "Administration Updates Documentation Collection Process and Releases Guidance to Expedite Permanent Modifications," Jan. 28, 2010, *available at* **http://www.financialstability.gov/latest/pr_01282010.html**.

> "The choice we appear to be making is trying to modify our way out of this, which has the effect of lengthening the crisis," said Kevin Katari, managing member of Watershed Asset Management … "We have simply slowed the foreclosure pipeline, with people staying in houses they are ultimately not going to be able to afford anyway. Mr. Katari contends that banks have been using temporary loan modifications under the Obama plan as justification to avoid an honest accounting of the mortgage losses still on their books. Only after banks are forced to acknowledge losses and the real estate market absorbs a now pent-up surge of foreclosed properties will housing prices drop to levels at which enough Americans can afford to buy, he argues.[80]

In other words, although home prices have dropped, they are still too high for normal activity in the market to resume. Moreover, it appears that the danger of another banking crisis brought on by mortgage-backed securities remains. As Kevin Williamson put it in *National Review*:

> There are two main dangers proceeding from the Obama Administration's attempts to intervene in the mortgage market as a way to prop up housing prices: The first is that the program won't work, and the second is that it will. If the program fails, it will, like the stimulus … simply represent the frittering away of another mile-high round of money on political flimflam that does little to benefit most Americans and nothing to address the fundamental problems plaguing our economy. If it works, it will represent a victory for the nefarious forces of C.R.I.B. – the Committee to Re-Inflate the Bubble – setting the economy up for a vicious second round of financial crisis with its roots in the housing market.[81]

HAMP might harm the housing market in other ways, as well. First, widespread HAMP modifications might add more uncertainty to the market for mortgage-backed securities and have a negative impact on the value of such securities. The result, of course, would be more expensive mortgages for consumers. Second, as suggested above, HAMP may also create a new class of misunderstood, complex mortgage products that further expose the American economy to systemic risk.

REDUCING PRINCIPAL FOR DISTRESSED HOMEOWNERS WOULD BE PROBLEMATIC

In the wake of HAMP's failure to assist homeowners in the promised numbers, some Democrats and market observers have called for the federal government to directly pay to reduce the principal of homeowners' loans. Such efforts would be dubious for several reasons. First, writing down the value of a loan, in most cases, "will not provide enough of a decrease to cushion the kinds of income decline that push people into foreclosure."[82]

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[80] *Id.*

[81] Kevin Williamson, "Smoking HAMP: On housing, Obama's successes are as dangerous as his failures," *National Review*, Jan. 25, 2010.

[82] Megan McArdle, "Mortgage Modifications: Help or Hindrance?" *The Atlantic Business*, Jan. 4, 2010, *available at* **http://business.theatlantic.com/2010/01/mortgage_modifications_help_or_hindrance.php**.

Second, "Treasury Department officials have worried that if some borrowers get their principals reduced, even borrowers who aren't behind will stop paying unless they get the same break."[83] Third, reducing principal on a large scale might hurt U.S. banks' liquidity and solvency and trigger another banking crisis. The *Wall Street Journal* reports:

> U.S. banks, thrifts and credit unions held about $952 billion of home equity and other junior-lien mortgages as of Sept. 30, according to Federal Reserve data. If the principal owed on first mortgages is reduced, the institutions probably would have to write down or write off many of the second-lien loans, potentially sapping their capital.[84]

Without a broad-based economic recovery and millions of new jobs, it is difficult to see how principal reduction could help save a large number of homes from foreclosure.

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[83] James Hagerty, "Mortgage Mess Breeds Unlikely Allies," *The Wall Street Journal*, Feb. 9, 2010.
[84] *Id.*

About the Committee

The Committee on Oversight and Government Reform is the main investigative committee in the U.S. House of Representatives. It has authority to investigate the subjects within the Committee's legislative jurisdiction as well as "any matter" within the jurisdiction of the other standing House Committees. The Committee's mandate is to investigate and expose waste, fraud and abuse.

Contacting the Committee

For press inquiries:

Frederick R. Hill, Director of Communications
(202) 225-0037

For general inquires or to report waste, fraud or abuse:

Phone: (202) 225-5074
Fax: (202) 225-3974
http://republicans.oversight.house.gov

Committee on Oversight and Government Reform
Ranking Member, Darrell Issa (CA-49)

B350A Rayburn House Office Building
Washington, DC 20515
Phone: (202) 225-5074 • Fax: (202) 225-3974