

The Chasm between Words and Deeds

Lenders Not Modifying Loans as They Say To Avoid Foreclosures



By Joe Raedle, Getty Images

California Reinvestment Coalition
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EXECUTIVE SUMMARY

Lenders began foreclosure proceedings on nearly 60,000 Californians in August alone. The consequences of these growing foreclosures are being felt by families who have lost their main asset and residence, neighborhoods that suffer lower property values, local governments that incur increasing costs and decreasing tax revenue, and the broader California economy which is heavily dependent on the housing market. Yet a key question remains - is foreclosure the only option?

Approximately two million loans are facing rising interest rate resets in the U.S. over the next two years, and many borrowers will be unable to meet their increased mortgage payment. Over 500,000 Californians may be at risk of foreclosure. For many of these borrowers, perhaps the best they can hope for is that they will be able to negotiate with their loan servicer for a loan modification, which would make the terms of the loan more affordable to them.

The good news is that servicers routinely say they want to negotiate loan modifications and keep borrowers in their homes. The bad news is that anecdotes and data suggest that these loan modifications are not really occurring.

CRC surveyed 33 of the roughly 80 mortgage counseling agencies across the state which are certified by the U.S. Department of Housing and Urban Development to assist borrowers at risk of foreclosure. Mortgage counseling agencies are often the only place for borrowers to turn when they are faced with foreclosure. Counselors help borrowers understand their options and often act as intermediaries between borrowers and their lenders. The groups that responded to this CRC survey served approximately 9,800 consumers, including nearly 3,800 consumers through in-person meetings, in the month of August alone. Sadly, they reported that the most common outcomes for these borrowers were foreclosures and short sales, both of which result in home loss.

Key Findings:

Lenders not responsive. Agencies were asked if servicers consistently modify loans by fixing interest rates for the life of the loan. Most counseling agencies reported that the industry as a whole is not consistently modifying loans for long term affordability.

Postponing the day of reckoning. In general, for borrowers in early delinquency or facing unaffordable interest rate resets, servicers are not fixing interest rates for the long term. Counseling groups were most likely to respond that lenders were only willing to fix interest rates for one year at a time when they were willing to modify loans. This was true for individual lenders and for all lenders as a whole. These short term modifications most likely only delay the problem for another year, and are akin to giving the borrower another bad loan with a short period of affordability followed by increasing payments that may be difficult for the borrower to afford.

Devastating Borrower Outcomes. Counseling agencies were asked about common outcomes for borrowers having trouble with their loans:

- *Foreclosures lead.* Groups were most likely to report foreclosure a “very common” outcome for borrowers. 19 groups reported foreclosure as a very common outcome.
- *Short sales next.* 11 groups cited short sales - where servicers agree to allow homeowners to sell the property for less than the amount of money owed – as a “very common” outcome for borrowers.
- *Beneficial loan modifications and refinances are not happening.* A large 21 groups reported that refinancings were “not common” and 15 groups reported that loan modifications were “not common.” Only one counseling agency responded that loan modifications are a “very common” outcome for borrowers; only one group responded that refinancings were a “very common” outcome for borrowers.

No early outreach to borrowers in trouble. Despite lenders assertions about reaching out to borrowers BEFORE they face problems from rising interest rates and increasing monthly payments, most counseling agencies do not see this happening. Most groups said that in their experience, the industry as a whole was NOT making contact with borrowers before delinquency. Only one group reported that early contact was being made.

Out of the mouths of mortgage counselors- frustration. When asked to comment on servicers that are especially difficult to work with, counseling agencies expressed frustration with companies that do not offer any real solutions and that provide poor customer service. Representative of counselor comments was this: “All lenders said they don’t want to foreclose on home[s]. But when it comes to giving their customers an option, they always want the full amount of the delinquency and refuse to change the terms to help the borrower.”

Moody’s says loan modifications are not happening. Ratings agency Moody’s recently released the results of a survey it conducted of the modification practices of subprime mortgage servicers regarding borrowers that have or will experience an interest rate reset on their loans in either 2007 or 2008. Sixteen servicers with a total servicing volume of approximately \$950 billion, or roughly 80% of the market, provided data. “Specifically, the survey showed that most servicers had only modified approximately 1% of their serviced loans that experienced a reset in the months of January, April and July 2007.”

Recommendations

In order to keep borrowers in their homes, and to address the concerns of housing counseling agencies, CRC urges lenders and policy makers to each take 4 key steps.

Lenders Must:

- 1. Modify loans to keep all borrowers in their homes.** Lenders should lower interest rates, convert adjustable rate loans to fixed rate loans for the long term, and reduce the amount of money owed in order to stabilize families.
- 2. Be more transparent and accountable.** Servicers must report semiannually on their loss mitigation outcomes, including how many loans went to loan modification, refinance, payment plan, forbearance agreement, short sale, deed in lieu, and foreclosure.
- 3. Return foreclosed properties to the community.** Lenders should develop a process to sell foreclosed properties to nonprofit groups so that properties won't fall into the hands of unscrupulous speculators and disinterested investors. Local nonprofits that acquire these properties can help first time homebuyers build assets or create affordable rental housing opportunities that preserve the property as a community asset.
- 4. Support home loan counseling agencies and legal service providers.** Lenders should dramatically increase funding for counseling agencies and legal service providers who are on the front lines of the foreclosure crisis.

Policy Makers Must:

- 1. Pass laws that promote loan modifications and tax relief for short sales.** Congress needs to amend the Bankruptcy Code to permit bankruptcy judges to modify the terms of homeowners mortgages, and provide tax relief for the increasing number of borrowers facing a short sale.
- 2. Develop a state rescue refinance loan product.** Efforts to expand FHA loan products are positive but will not go far enough to help most homeowners in distress in California. The state must step into this void to help low and moderate income borrowers who have been victimized by predatory lending practices and are at risk of losing their homes. With California in the midst of a foreclosure crisis, the legislature and Governor did little this session to help borrowers at risk of losing their homes.
- 3. Pass strong anti predatory lending legislation to ensure problems don't recur.** Congress and the state legislature must prevent this crisis from recurring by passing strong anti-predatory lending legislation that requires that loans be suitable for borrowers, and that bans prepayment penalties and yield spread premiums. Legislation must hold investors and Wall Street firms liable for violations so that they will stop financing predatory loans that place borrowers at risk.
- 4. Provide real oversight.** Legislators must fulfill their oversight responsibilities and ensure that regulatory agencies are monitoring compliance of lenders and brokers and taking enforcement actions to deter unlawful lending practices.

INTRODUCTION

Lenders moved to foreclose on nearly 60,000 Californians in August alone. The consequences of these growing foreclosures are being felt by families who must find new places to live, neighborhoods that witness a further decline in property values, local governments that suffer costs and decreased tax revenue, and the broader California economy which is heavily dependent on the housing market. Yet a key question remains - was foreclosure the only option?

In May, when foreclosure rates began skyrocketing to record-breaking numbers, the California Reinvestment Coalition called on the state's largest home mortgage lenders to create alternatives to foreclosure. In initial meetings with these lenders, they promised that they would do all they could to keep Californians in their homes, including modifying loan terms and rates to make them more affordable to borrowers facing foreclosure. But months after these promises were made, borrowers and their mortgage counselors say lenders are unwilling to provide loan modifications and other alternatives to help troubled borrowers.

Lenders are not required to quantify their promises and, as an industry, have offered no real and verifiable reporting to show that they are working with borrowers to prevent foreclosure. CRC conducted this survey of 33 mortgage counseling agencies across the state to determine what assistance lenders are offering borrowers. Sadly, counselors reported that the most common outcomes for their borrowers were foreclosures and short sales, neither of which keeps borrowers in their homes or works to solve the growing crisis.

Mortgage counseling agencies are often the only place for borrowers to turn when they are faced with foreclosure. Counselors help borrowers understand their options and often act as intermediaries between borrowers and their lenders. In California, there are roughly 80 mortgage counseling offices approved by the Department of Housing and Urban Development (HUD) to provide services that include loss mitigation, mortgage delinquency and default resolution, predatory lending and post purchase counseling. More than one-third of these counseling agencies took part in CRC's survey. The groups that responded to this CRC survey served approximately 9,800 consumers, including nearly 3,800 consumers through in-person meetings, in the month of August alone. This was an increase of 3,700 consumers, including 1,600 additional face to face meetings, from February of this year. Based on their experiences, the counselors report that lenders have not been easy to work with, and have not been as quick to offer loan modifications as they claim.

SURVEY OF HOME LOAN COUNSELING AGENCIES

Counseling agencies report that times are tough for homeowners in California, and that home loan servicers are not providing enough flexibility to help borrowers avoid foreclosure and short sale. Counseling agencies were asked to answer a few questions about their success in working with servicers. The state's largest servicers were pulled out for consideration: Bank of America, Citibank, Countrywide, HSBC, JPMorgan Chase, Merrill Lynch (Wilshire, HLS), Washington

Mutual, and Wells Fargo. A category of “all lenders” was also included to survey counselors on their impressions of industry performance as a whole.

Over the last few years, lenders and brokers sold many loans to borrowers that borrowers could not understand or afford to repay. Even the banking regulators recognized this and have since proposed guidance on nontraditional and subprime lending to tighten underwriting standards.

But in too many cases, the damage has been done, and borrowers are stuck with loans that have resetting interest rates that will make the loans impossible to pay. Approximately two million loans are facing rate resets in the U.S. over the next two years, and many will be unable to meet their increased mortgage payment. Over 500,000 Californians may be at risk of foreclosure. For many of these borrowers, perhaps the best they can hope for is that they will be able to negotiate with their loan servicer for a loan modification, which would make the terms of the loan more affordable to them.

Federal Deposit Insurance Corp. Chair Sheila Bair has commented on the need for servicers to do more to keep borrowers in their homes. “I’m frustrated that... we’re getting reports that servicing restructuring has not reached the level that I hoped it would,” she said. “We have this huge problem on our hands, and we can’t do this kind of case-by-case, laborious restructuring process with all these millions of loans,” Ms. Bair said. I think some categorical approaches are needed... Just convert that mortgage into a fixed-rate mortgage, keep it at the starter rate, convert it into a fixed rate, make it permanent, and get on with it,” Ms. Bair said.¹

California housing counseling agencies surveyed confirm that more needs to be done.

Lenders not responsive. Agencies were asked if particular servicers, and servicers in general, consistently modify loans by fixing interest rates for the life of the loan.

- *No long term modifications.* 24 groups responded that the industry as a whole is not consistently modifying loans for long term affordability.
- *Best of the worst.* HSBC received the “most” favorable responses, but only 5 groups reported that HSBC consistently modifies loans with fixed rates for the life of the loan. At the same time, 19 groups responded that HSBC does not do this.
- *Worst of the worst.* Merrill Lynch received only one response stating that it modifies loans for the long term and 13 responses that it does not.

Postponing the day of reckoning. In general, for borrowers in early delinquency or facing unaffordable rate resets, servicers are not fixing rates for the long term. Groups were asked if individual servicers, and servicers as a whole, were fixing interest rates for 1 year, 2 years, 5 years, or more.

- *Short term “fixes.”* Counseling groups were most likely to respond that lenders were only

¹ Joe Adler, “Bair: Increase Modifications,” American Banker, September 28, 2007.

willing to fix interest rates for one year at a time when modifying loans. This was true for individual lenders and for all lenders as a whole. These short term modifications most likely only delay the problem for another year, and are akin to giving the borrower another bad loan with a short period of affordability followed by increasing payments that may be hard to make.

- *Best of the worst.* Individual servicers were reported to be willing to fix interest rates for 1, 2, 5, or more years.
 - 4 groups responded that Wells Fargo was willing to fix interest rates for 2 years when modifying loans.
 - 2 groups responded that Citibank and HSBC were willing to fix interest rates for 5 years when modifying loans.
 - 2 groups responded that Countrywide was willing to fix interest rates for more than 5 years when modifying loans.
- *Worst of the worst.* Merrill Lynch was the only servicer to receive 0 responses that it is willing to modify loans for 5 years, or more than five years.

Devastating borrower outcomes. Counseling agencies were asked how common the following different loss mitigation outcomes were for their borrowers: loan modification, forbearance agreement, refinance loan, short sale, foreclosure, or “other.”

- *Foreclosures lead.* Groups were most likely to report foreclosure a “very common” outcome for borrowers. 19 groups reported foreclosure as a very common outcome.
- *Short sales next.* 11 groups cited short sales - where servicers agree to allow the homeowners to sell the property for less than the amount of money owed – as a “very common” outcome for borrowers. While preferable to foreclosure, short sales leave the borrower without a home, and may result in a higher tax bill.
- *Loan modifications and refinances not happening.* A large 21 groups reported that refinancings were “not common” and 15 groups reported that loan modifications are “not common.” Only 1 counseling agency responded that loan modifications are a “very common” outcome for borrowers; only 1 group responded that refinancings were a “very common” outcome for borrowers. For borrowers facing foreclosure, refinancing and loan modification are relatively good outcomes. That these positive outcomes are not occurring on the ground on any scale is distressing.
- *Forbearance agreements* presented a mixed picture. They were listed as “very common” by 8 groups, “somewhat common” by 12 groups, and “not common” by 8 groups.

No outreach to borrowers in trouble. Despite lenders assertions about reaching out to borrowers BEFORE they face problems from rising interest rates and higher monthly payments, most counseling agencies do not see this happening.

- *No early contact.* For the industry as a whole, a surprising 24 respondents said that in their experience, lenders were NOT making contact with borrowers before delinquency. Only one group reported that early contact was being made with borrowers at risk of foreclosure.

- *Best of the worst.* Citibank received 5 votes for its willingness to work with borrowers before reset. At the same time, 9 respondents said Citibank is not willing to work with borrowers before delinquency.
- *Worst of the worst.* HSBC, Merrill Lynch and Wells Fargo each received 2 responses stating that they reach out to borrowers before delinquency. Yet 15 respondents said that HSBC does NOT show a willingness to work with borrowers before delinquency, as did 13 respondents for Merrill and 15 respondents for Wells.

Servicers hard to work with. Counseling agencies were asked, “in your experience, which lenders/servicers are the most difficult to work with in trying to keep borrowers in their homes? Why?”

- A total of 13 companies were named as servicers that are difficult to work with.
- Countrywide, Merrill Lynch (which owns Wilshire, HLS and First Franklin) Washington Mutual and Wells Fargo were named most often, 5 times each, for being difficult.
- Other companies named include: Chase, Ocwen, Nova, Option One, Gateway, GMAC, Litton, Specialized Loan Servicing, and HSBC.

Out of the Mouths of Counseling Agencies. When asked to comment on companies that are especially difficult to work with, counseling agencies had a lot to say. Comments expressed frustration with companies that do not offer any real solutions and that provide poor customer service. Below is a sampling of comments made by counseling agencies. For additional comments, please see Appendix I.

“All lenders said they don’t want to foreclose on home[s]. But when it comes to giving their customers an option, they always want the full amount of the delinquency and refuse to change the terms to help the borrower.”

“They make it very difficult for the borrowers to communicate. They send letters to the borrowers offering payment options and once the borrower calls, they say those letters are generated by their computer system. Once the borrowers come to get our help, we as counselors have a hard time getting to [the] right person. Even with direct numbers, we still have a hard time reaching those individuals.”

“We find that due to high volumes of calls from consumers concerning mortgage delinquency issues and a shortage in lender/servicer personnel, many consumers may not receive the attention they require to avoid foreclosure. Additionally, we find that some lenders are not inclined to accept partial payments during the borrower’s period of hardship. There are instances where the lender will not supply a permanent loan modification during pre-foreclosure. We would suggest that lenders be more proactive with borrowers by seeking to contact them prior to serious delinquency, and by being more flexible in their programs to resolve delinquency issues and avoid foreclosure. Lenders providing specialized departments dedicated to working with housing counseling agencies seeking to assist

distressed homeowners with foreclosure prevention initiatives have been beneficial to the homeowner.”

Counseling Agencies Large and Small. The groups that took the time to fill out this survey represent a cross section of counseling agencies in the state.

- Groups came from various parts of California, including northern California, the San Francisco Bay Area, the Central Valley, greater Los Angeles, and the San Diego region. Groups work in rural and urban areas.
- There was a fairly even distribution of the number of clients served by respondents. Groups that responded to the question were evenly distributed in the following buckets: groups that saw up to 10 clients in the month of August; groups that saw up to 20 clients; groups that saw up to 50 clients; and groups that saw close to 100 clients. One group reported seeing a few hundred clients in the month of August. Finally, one group served a few thousand clients in the month of August. A few agencies did not answer this question.
- Most groups reported a near doubling in the number of clients served over the last 6 months. The groups that responded to this CRC survey served approximately 9,800 consumers, including nearly 3,800 consumers through in-person meetings, in the month of August alone. This was an increase of 3,700 consumers, including an additional 1,600 face to face meetings, from February of this year.

INCREASING DISCUSSIONS BUT NO CLEAR RESULTS

Lenders declare desire to do workouts. In public statements, at Congressional and regulatory hearings, and in meetings with the California Reinvestment Coalition and other community groups, lenders repeat the now common refrain that is in everyone’s interest – borrower, lender, servicer, investor – to keep the borrower in her home and avoid foreclosure.

“Nobody wins when a borrower loses his or her home to foreclosure – not the banker, not the borrower and not America’s communities,” according to Mortgage Bankers Association Chair John Robbins, CMB.²

“It is always in the best interest of the servicer, the borrower, and the investors if we can modify a loan, because foreclosure means there’s no chance the investor is going to recoup their money,” said Tom Kelly, a spokesman for JPMorgan Chase & Co.³ Yet as foreclosures mount, there is no clear evidence that loan modifications and workouts are occurring at any scale.

Steps in the right direction. The public discourse has broadened to include discussion about the importance of loss mitigation and loan modifications, and government at various levels is looking to encourage loan workouts. This is all for the good.

² Mike Sorohan and John Mechem, “Democrats Call for Foreclosure Prevention Action,” MBA, October 4, 2007.

³ Kate Berry, “A Speed Bump for Mortgage Workout Efforts,” American Banker, September 26, 2007.

In May of this year, Senator Christopher Dodd announced a Statement of Principles which called on lenders to contact borrowers early in the process, modify loans to create long term affordability, dedicate resources to aid large scale modifications, encourage low cost refinancings for those who qualify, and work with the GSEs to ensure credit is available.⁴

Additionally, federal banking regulators have encouraged financial institutions to do loan workouts by offering Community Reinvestment Act credit and by clarifying that institutions will not face regulatory penalties if they pursue reasonable workout arrangements with borrowers.⁵

Another positive development is the announcement by Attorneys General and banking regulators from 10 states, including California, that they have formed a task force hoping to persuade mortgage servicing companies and investors in mortgage backed securities to increase the number of troubled subprime loans they restructure to stem the tide of foreclosures.⁶

Additionally, the California Department of Financial Institutions is currently surveying state lender licensees about the dollar volume and number of loans that have been subject to foreclosure, short sale, or have been subject to rewrite or workout, over an 8-month period. The California Department of Corporations may similarly survey licensees on loss mitigation outcomes, though it has not yet done so.⁷

No accountability. Sadly, the growing attention paid to these issues has yet to translate into greater action for distressed homeowners. Currently, servicers are under no obligation to provide meaningful, consistent and verifiable data to regulators and the public about their success in helping borrowers stay in their homes. Accordingly, few servicers provide any information at all, and for those that do, it is not clear what the public is to make of the information provided.

Countrywide as example. A case in point is Countrywide, which recently announced it was working to modify loans. Countrywide said that it expects to modify terms on nearly 25,000 home loans this year to help people avoid foreclosure. The company said it has already modified more than 17,000 home loans this year, and provided assistance on about 35,000 mortgages, including through repayment plans, postponement of payments and refinancings.⁸ “Our number one priority is to help borrowers stay in their homes,” said Steve Bailey, Senior Managing

⁴ “Homeownership Preservation Summit Principles Update, Office of U.S. Senator Chris Dodd,” May 2, 2007, www.dodd.senate.gov.

⁵ “Federal Regulators Encourage Institutions to Work with Mortgage Borrowers Who Are Unable to Make Their Payments,” Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, April 17, 2007.

⁶ The group, which includes the Attorney General of the state of California, wants servicers to create longer term solutions for distressed borrowers, such as lowering the borrowers’ mortgage interest rate, rather than creating a repayment plan that offers a temporary fix. A policy paper prepared as part of the effort by Iowa Attorney General Patrick Madigan suggests, among other things, that servicers boost their loan-modification staffs, create teams dedicated to handling loan modifications, increase training and provide front line employees with financial incentives that would encourage them to save homes rather than moving borrowers towards foreclosure. Ruth Simon, “Task Force Will Seek More Loan Revisions,” *The Wall Street Journal*, September 8-9, 2007.

⁷ Final Report, “Preserving the American Dream: Homeownership Preservation and the Subprime Mortgage Crisis,” Senate Committee on Banking, Finance and Insurance, September 2007.

⁸ Jonathan Stempel, “UPDATE 1-Countrywide sees modifying 25,000 mortgages in ‘07,” *Reuters*, September 24, 2007.

Director of Loan Administration. “Countrywide has the right tools, processes and staff to help homeowners avoid foreclosure.”⁹

But what do these numbers mean? On one investor conference call, Countrywide officials responded to a related question by saying, “most of the modifications do ... represent the deferment of past due interest or capitalization of the past due amount. And, to a far lesser extent – in fact, it is not very material at all the percent that represent – interest rate reductions.”¹⁰ This suggests that Countrywide may be focusing more on pushing back delinquent payments than in restructuring loans to provide long term affordability.

A recent *New York Times* article provided another perspective on Countrywide’s statement. It noted that Countrywide claimed it provided assistance on a mere 8.8% of the loans in its servicing portfolio that were in delinquency. The article also suggested that up to 14% of the assistance Countrywide was counting included short sales and deeds in lieu of foreclosure,¹¹ both of which result in the borrower losing her home. Countrywide responded saying it provided workout programs to keep more than 35,000 mortgagors in their homes, and assisted with short sales and deeds in lieu for nearly 5,000 borrowers who did not have the financial means to stay in their homes. Countrywide asserted that it anticipated completing 25,000 loan modifications this year.¹² The difficulty in reconciling these numbers and understanding their significance argues for more consistent, verifiable and detailed reporting obligations on all servicers.

Investor interests as barrier. It is not clear that the industry is united in its desire to see loan modifications and workouts for borrowers in trouble. Most investors in attendance at a recent Subprime Asset Backed Securities Conference reportedly indicated that they are not pleased with subprime servicers’ growing reliance on loan modifications to avoid foreclosure. Jason Stewart, a portfolio manager at Barrier Investments, a company that advises and manages hedge funds, said loan modifications hurt profits for those who purchase investment grade tranches of subprime MBS. “Loan modifications only benefit a few people: the people at the bottom of the capital structure,” he said. According to Inside B&C Lending, investors are concerned because loan modifications affect subprime MBS payment triggers. And at least one subprime servicer is moving away from such loss mitigation techniques.¹³

Yet, “the loan modifications that investors are so concerned about seem to be fairly far down the preference list of loss mitigation options. ‘So far the use of loan modifications is very limited compared to other loss mitigation options,’ according to Diane Pendley, a managing director at Fitch Ratings.”¹⁴

⁹ “Borrowers Facing Challenges Urged to Contact Countrywide’s Home Retention Team,” CNN Money, September 24, 2007.

¹⁰ Comments of Kevin Bartlett from Countrywide Financial Investor teleconference for Q2 2007, July 24, 2007

¹¹ Gretchen Morgensen, “Can These Mortgages Be Saved,” *New York Times*, September 30, 2007.

¹² “Countrywide Response to the *New York Times*,” September 28, 2007.

¹³ “Investors Ready to Buy Subprime Mortgages, but Predict Delays,” Inside B&C Lending, September 21, 2007.

¹⁴ “Servicers, Investors at Odds As Defaults and Costs Rise,” Inside B&C Lending, October 5, 2007.

Industry practices as barrier. Further, the industry still needs to change practices that create disincentives to loan modification. “Certain processes in the industry are driving the wrong behavior,” said Wes Mee, an executive vice president and the chief operating officer of First American Corp’s national default title service. For example, he said foreclosure attorneys are not paid for doing workouts and actually get higher ratings and earn foreclosure fees if a borrower goes into foreclosure.¹⁵ The industry should identify and eradicate such barriers to loan modification.

Servicers overwhelmed, borrowers suffer. Clearly, servicers are having difficulty keeping up with the growing wave of delinquent borrowers. “Despite much talk of proactive efforts by the mortgage industry to work with troubled homeowners, evidence is beginning to accumulate that many servicers are struggling just to process, let alone resolve, the surging defaults... At least 2 of the top 5 servicers have been telling borrowers it will take two to three months to determine whether a loan qualifies for a workout, according to Ron Morgan, the president of strategic default solutions at MortgageHub Inc. ‘Such delays push more borrowers into foreclosure.’ he said.”¹⁶ Servicers must commit additional resources to meeting the increased demand for loss mitigation services so that borrowers do not suffer further.

Moody’s says loan modifications are not happening. On September 21, 2007 Moody’s released the results of a survey it conducted of the modification practices of subprime mortgage servicers regarding borrowers that have or will experience an interest rate reset on their loans in either 2007 or 2008. Sixteen servicers with a total servicing volume of approximately \$950 billion, or roughly 80% of the market, provided data. “Despite much industry dialogue and heavy press attention on the topic of loan modifications as a mitigation technique to avoid foreclosure and reduce losses on defaulted loans, the survey results suggest that on average subprime servicers have only recently begun to materially increase the number of modifications as it relates to interest rate resets. Specifically, the survey showed that most servicers had only modified approximately 1% of their serviced loans that experienced a reset in the months of January, April and July 2007... Based on the survey results, Moody’s is concerned that the number of modifications that will be performed in the future by subprime servicers on loans facing resets may be lower than what will be needed to significantly mitigate losses in subprime pools backing rated securitizations.”¹⁷

Many industry, regulatory and consumer groups seem to agree that borrowers are not benefiting from loan modifications and other positive alternatives as they should.

¹⁵ Kate Berry, “A Speed Bump for Mortgage Workout Efforts,” American Banker, September 26, 2007.

¹⁶ Kate Berry, “A Speed Bump for Mortgage Workout Efforts,” American Banker, September 26, 2007.

¹⁷ “Moody’s Subprime Mortgage Servicer Survey on Loan Modifications,” Structured Finance Special Report, September 21, 2007.

RECOMMENDATIONS

In order to keep borrowers in their homes, and to address the concerns of housing counseling agencies, CRC urges lenders and policy makers to each take 4 key steps. Many of these concepts are found in the California Reinvestment Coalition's Homeownership Preservation Best Practices. For the full list of Best Practices, see Appendix II.

Lenders Must:

1. Modify loans to keep all borrowers in their homes. Lenders must focus resources on loan modifications that provide borrowers with loans that are affordable for the long term. Lenders should lower interest rates, convert adjustable rate loans to fixed rate loans for the long term, and reduce the amount of money owed in order to stabilize families. For adjustable rate loans that will become unaffordable when rates reset, lenders must convert the loans into fixed rate loans where the interest rate is fixed for the remainder of the life of the loan.

2. Be more transparent and accountable. Servicers must report semiannually on their loss mitigation outcomes, including how many loans went to loan modification, refinance, payment plans, forbearance agreements, short sales, deeds in lieu, and foreclosures. Servicers should report on whether loans are modified for a period of years, or for the life of the loan.

3. Return foreclosed properties to the community. Lenders should develop a process to sell foreclosed properties to nonprofit groups so that properties won't fall into the hands of unscrupulous speculators and disinterested investors. Local nonprofits that acquire these properties can help first time homebuyers build assets or create affordable rental housing opportunities that preserve the property as a community asset.

- Servicers should give nonprofits a right of first refusal to acquire foreclosed properties.
- Banks should develop and offer a low cost financing product for nonprofits who wish to buy these properties.

4. Support home loan counseling agencies and legal service providers. These groups are on the front lines of efforts to prevent foreclosure. Lenders, policy makers and community groups are referring more and more consumers to these agencies, but their capacity is being stretched to meet the increased demand. Lenders should dramatically increase funding for counseling agencies and legal service providers as they deal with a problem not of their making.

Policy Makers Must:

1. Pass laws that promote loan modifications and tax relief for short sales. Congress is currently considering a number of bills to help distressed homeowners.

- Congress needs to amend the Bankruptcy Code to permit bankruptcy judges to modify the terms of homeowners' primary mortgages, including by lowering interest rates and

cramming down the amount of money owed.

- Congress should also provide tax relief for the increasing number of borrowers facing a short sale, where borrowers agree to sell the home for less than the amount of money owed, and have the lender forgive the remainder of the debt.

2. Develop a state rescue refinance loan product. Efforts to expand FHA loan products are positive but will not go far enough to help most homeowners in distress in California. The state must step into this void to help low and moderate income borrowers who have been victimized by predatory lending practices and are at risk of losing their homes. Other states are already doing this. With California in the midst of a foreclosure crisis, the legislature and Governor did little to help borrowers at risk of losing their homes. The California state legislature considered a bill earlier this year that would have authorized the state housing finance agency to develop a rescue refinance product, but the bill died in committee.

3. Pass strong anti predatory lending legislation to ensure problems don't recur. Many of the problems we face today could have been dealt with in years past with stronger consumer protection legislation. Congress and the state legislature must commit to preventing this crisis from recurring by passing strong anti predatory lending legislation that requires that loans be suitable for borrowers, and that bans prepayment penalties and yield spread premiums (fees the broker receives from the lender for selling a higher interest rate to a borrower). Legislation must also hold investors and Wall Street firms liable for violations so that they will exercise increased due diligence and refrain from financing predatory loans.

4. Provide real oversight. Federal and state regulators have not fulfilled their obligation to examine lenders and brokers for compliance with existing law. We are now witnessing the devastating consequences of this failure. Legislators must fulfill their oversight duty and ensure that agencies are monitoring compliance and taking enforcement actions to deter unlawful lending practices.

APPENDIX I: COMMENTS OF COUNSELING AGENCIES

Counseling agencies were asked, “In your experience, which lenders/servicers are the most difficult to work with in trying to keep borrowers in their homes? Why?” Their responses follow:

“Usually when I called the lender during the counseling so that my client can talk to them and request a working plan, there is no help from the lender or servicer. Usually [it’s] because there is not enough money to cover the new reset payment. For the most part, my clients would like for the lender to keep the original interest to be able to keep making the house payments.”

“In our experience ASC, Nova Mortgage and most servicers have been difficult to work with. The servicers have a standard check list for their so called foreclosure solutions that do not assist the delinquent homeowners in a significant form.”

“Countrywide especially will not discuss options with counselors or clients until [the] mortgage is three months delinquent.”

“All lenders said they don’t want to foreclose on home[s]. But when it comes to giving their customers an option, they always want the full amount of the delinquency and refuse to change the terms to help the borrower.”

“Countrywide, GMAC, Wells Fargo, WAMU, Ocwen Loan Servicing, Litton Loan Servicing, Specialized Loan Servicing. They don’t care about the customer, they just care that they obtain their payment.”

“CHASE, all lenders based in Texas, secondary lenders, and all predatory lenders. Why? Borrowers are not able to work on any loan modification whatsoever. They make it very difficult for the borrowers to communicate. They send letters to the borrowers offering payment options and once the borrower calls, they say those letters are generated by their computer system. Once the borrowers come to get our help, we as counselors have a hard time getting to [the] right person. Even with direct numbers, we still have a hard time reaching those individuals.”

“Countrywide Advocacy Team which has been set up is non responsive to counselors and will often refer to regular work out department who do not show the flexibility that was promised.”

“Ocwen - customer service/collection overseas.”

“WAMU- Collection Department does not communicate with LMIT Department.”

“Wells Fargo – Always loses documents. Taking over 2 weeks to document information on accounts.”

“Wilshire and Option One (won’t call borrower or counselor back).”

“Wells Fargo Bank, Washington Mutual and Wilshire. They give you the run around on what they need to qualify for the workout.”

“We have had a lot of difficulty even getting a person on the phone to talk with Washington Mutual, First Franklin, Countrywide and Gateway Bank. The turnaround time for getting a negotiator assigned to a client for WaMu to even begin loss mitigation procedures has been very long, over one month. In fact, we’re still waiting for two of our clients.”

“We find that due to high volumes [of] calls from consumers concerning mortgage delinquency issues and a shortage in lender/servicer personnel, many consumers may not receive the attention they require to avoid foreclosure. Additionally, we find that some lenders are not inclined to accept partial payments during the borrower’s period of hardship. There are instances where the lender will not supply a permanent loan modification during pre-foreclosure. We would suggest that lenders be more proactive with borrowers by seeking to contact them prior to serious delinquency, and by being more flexible in their programs to resolve delinquency issues and avoid foreclosure. Lenders providing specialized departments dedicated to working with housing counseling agencies seeking to assist distressed homeowners with foreclosure prevention initiatives have been beneficial to the homeowner.”

“Wells Fargo mortgage loans [are] questionable to begin with. Unable to reach loss mitigation until too late. Cut off several times, faxes never arrived. Lenders/servicers in connection with mortgage brokers – difficult to determine who lender/servicer is and then showing no interest in a work out of any kind. Uncooperative attitude with borrower.”

“HSBC – no loss mitigation department.”

“All lenders. No programs until homeowner 3 months past due. Past due amount is high and lenders usually want half down.”

“They are all pretty much the same overall. The biggest problem is that there is a high volume of cases to be worked in [a] small window of time. Adding to this problem is the fact that those assigned to work these cases do so with attitude of a collections agent rather than a counselor. It is for this reason that trained field outreach workers could and would provide a softer face to the consumers as representatives of the lender.”

“Countrywide: in a couple of cases, they have been unwilling to negotiate anything.”

“No one is able to achieve any workouts with any lenders and we have more foreclosures now than we have had in the last 10 years, by probably close to 100%. We also have huge problems with foreclosure rescue scams and no lender oversight and with tenants of foreclosed homeowners for whom lenders will do nothing but give brief notice and threatened eviction. We also have an impossible time trying to figure out who is the lender with which we need to negotiate.”

“Litton, WaMu, Wilshire Credit. Deaf to recommendation outside their script; dumb due to need for other approval levels; blind to consistently documenting the file since you seldom speak to the same person twice.”

“The most difficult to work with are the local brokers whose servicing provider makes it more challenging to modify the loan versus the larger institutions.”

“Countrywide, we have experienced a lack of priority to work with clients that are in need to modify or restructure loans.”

“On two reverse mortgage cases, Liberty was the lender and was very uncooperative. They don’t take phone calls and don’t respond timely to letters, either.”

“Seattle Mortgage was very cooperative and allowed our client more time to comply with the terms of her Rapid Rider so that she didn’t go into foreclosure.”

“The most common problems folks (consumers) report at the workshops are: difficulty in reaching someone on the phone they can talk to about workouts; no response to workout packages sent in; many consumers have 2 loans, which makes certain workouts nearly impossible; many consumers are dealing with servicers other than the original lender; many of loans are ARMs; most of the consumers don’t have equity in their house; as a (sort of) positive trend, we are seeing more people earlier on in the process – e.g. before the adjustable rate resets, or before they are actually in default. In the past, folks would tend to come in near the end of the process, i.e., just before the trustee sale. This may be because of a combination of 1) more general awareness of the problem; and 2) our outreach with the workshop format; the foreclosure rescue scams I have seen were done, say, a year ago. Most of the people that we see now bought or refinanced a year or 2 ago, and have no equity left. Many of the people we see complain they only now have learned the terms of their loans (e.g. thought they’d gotten a fixed rate, but ended up with an ARM.”

APPENDIX II: CRC'S HOME OWNERSHIP PRESERVATION BEST PRACTICES

Outreach and education of at risk homeowners

Lenders should form partnerships with and support nonprofit counseling agencies and related community groups in order to reach and counsel the hundreds of thousands of California borrowers at-risk of foreclosure, including the 50% of borrowers who go into foreclosure without contacting their lender.

- Servicers should provide early notice to borrowers who are facing loans with resetting interest rates. Lenders should contact borrowers 6 months prior to the rate reset, informing borrowers about how much their new payments will be, and urging them to contact the servicer if they will have trouble with the new payments. Outreach to borrowers is best done in partnership with a locally known and trusted community group, through co-branded letters, community meetings, referrals and related approaches.
- Lenders and servicers should fund community groups to contact, counsel and make loss mitigation recommendations for their borrowers.
- All public education materials and communication should be in the various languages spoken by borrowers in California.
- Lenders and servicers should fund and build the capacity of community based organizations over the next few years so that these groups can respond to the crisis we are now facing.

Strong loss mitigation policies to keep borrowers in their homes

Lenders should focus resources on loan modifications that provide borrowers with loans that are affordable for the long term. Lenders should lower interest rates, convert adjustable rate loans to fixed rate loans for the long term, and reduce the amount of money owed in order to stabilize families.

- For adjustable rate loans that will become unaffordable when rates reset, lenders should convert the loans into fixed rate loans where the interest rate is fixed for the remainder of the life of the loan. At a minimum, servicers should fix the interest rate for 5 years.
- Lenders should negotiate more aggressive loss mitigation provisions in their servicing agreements with investors. A big impediment to loan modifications comes from overly restrictive investor guidelines.

Transparency of loss mitigation efforts

Lenders should publicize their loss mitigation programs and the parameters they use in deciding how they can help distressed borrowers. This will encourage overwhelmed borrowers to come forward. Lenders should also report on their loss mitigation outcomes so that there is accountability built into the process of how lenders are dealing with their borrowers at risk of foreclosure.

- Servicers should develop public education materials describing their loss mitigation tools, such as loan modifications, repayment plans and short sales.

- Servicers should report semiannually on their loss mitigation outcomes, including how many loans went to loan modification, refinance, payment plans, forbearance agreements, short sales, deeds in lieu, and foreclosures.

Refinance Products

Lenders should offer special rescue refinance products for borrowers who are having difficulty making payments and who cannot qualify for a loan modification. Counseling agencies report they often have difficulty getting loan modifications for borrowers, including from the smaller servicing companies and where the original lender has gone out of business. Many borrowers who would have been able to refinance their loans in the past are unable to do so as home prices in the state have fallen.

- Lenders should offer refinance loans designed to help borrowers who are unable to meet their mortgage payments, but who have income to support a new loan. These loans should focus on borrowers' ability to repay the loan, and should discount whether borrowers currently owe more than their properties are worth or are behind on their current mortgage.
- Whenever a borrower contacts the servicer or lender, the servicer or lender should take that opportunity to see if the borrower qualifies for a lower cost loan, and, if so, offer the borrower that lower cost loan.
- Servicers should waive prepayment penalties in order to help struggling borrowers who are able to refinance to get out of unaffordable loans.

Provide grant funds to borrowers in distress

Lenders should provide funds to borrowers who are falling behind on mortgage and other payments. Relatively small amounts of money can make the difference for borrowers who are close to catching up on their mortgage payments, or who are eligible for good loan modifications but need some cash to pay delinquent taxes.

REO property disposition

Lenders should develop a process to sell foreclosed and related properties to nonprofit groups so that properties won't fall into the hands of unscrupulous speculators and disinterested investors. Local nonprofits that acquire these properties can help first time homebuyers to build assets, and can preserve the property as a community asset.

- Servicers should give nonprofits a right of first refusal to acquire REO properties.
- Banks should develop and offer a low cost financing product for nonprofits who wish to buy these properties.

Channel of communication

Lenders should establish a dedicated phone line and staff to work with counselors hitting barriers with frontline loss mitigation staff, and for advocates who are working with borrowers victimized by unsuitable loans they want to fix; better train servicers to act in line with company

policies regarding loan modifications; and create incentives at all levels for servicers to modify loans for long term affordability.

Good origination practices to prevent future problems

Lenders should improve lending practices and underwriting guidelines to ensure predatory loans are not sold and to ensure that we don't repeat the mistakes of the past to create a future crisis.

- Lenders should follow new federal guidance on nontraditional and subprime loans designed to ensure all borrowers can afford their mortgages, even after any future resetting of interest rates. The federal guidance should be extended to cover all state lenders and brokers.
- Lenders should stop originating stated income or no documentation loans, which have been responsible for much abuse in California.
- Lenders should develop effective oversight of mortgage brokers, some of whom have been responsible for predatory lending in California communities. Lenders should stop paying brokers Yield Spread Premiums that reward brokers for putting borrowers into loans with higher interest rates and with prepayment penalties.
- Lenders should ensure that all borrowers have access to the lowest priced loans that are offered by that lender and that lender's affiliates. Prime borrowers who enter through the subprime lender should have access to prime products. This is a serious fair lending issue.
- Lenders and brokers should translate key loan documents and loan terms into non English languages if the loan was negotiated in another language.