The Widening Chasm Between Words and Deeds IV

Federal and State Policy Initiatives Fail to Stall Foreclosures in California

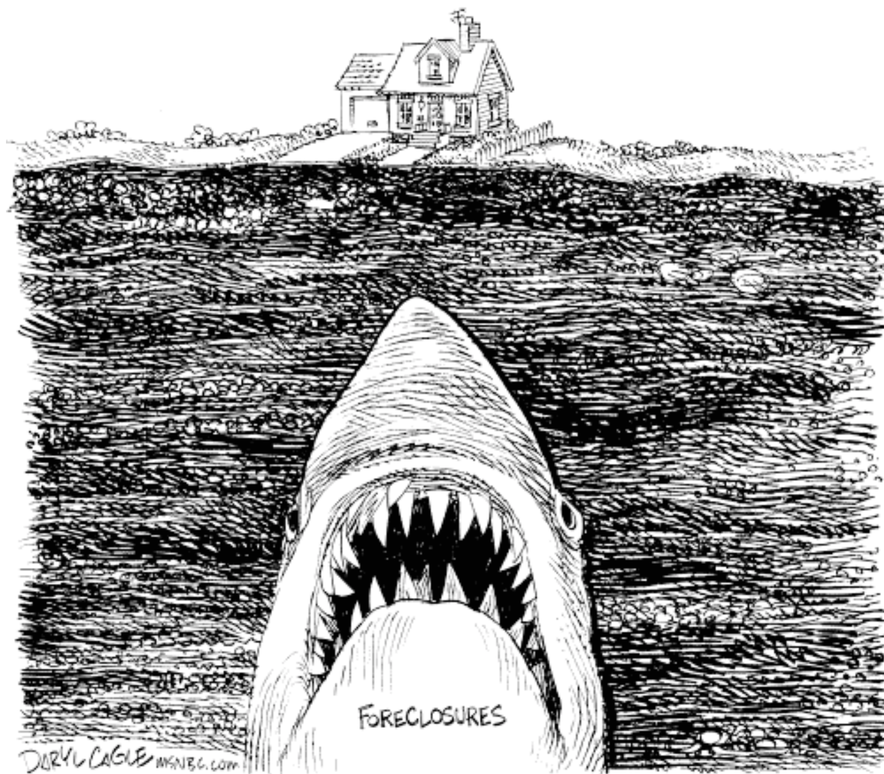


Illustration by Daryl Cagle of MSNBC.com

CALIFORNIA REINVESTMENT COALITION

PREFACE

The *Chasm Between Words and Deeds* reports provide snapshots of whether mortgage loan servicing companies are living up to their public commitments to help borrowers avoid foreclosure. These reports reflect the experiences of nonprofit home loan counseling agencies and legal service offices in California that are on the front lines of the foreclosure crisis, working hard to keep families in their homes. The previous reports focused on counselors' experiences in the months of August and December of 2007, and May of 2008. The first three surveys found that loan servicers were not modifying loans to any significant degree, were not conducting early outreach to borrowers facing rising mortgage payments, and that their most likely response to borrowers in distress was foreclosure.

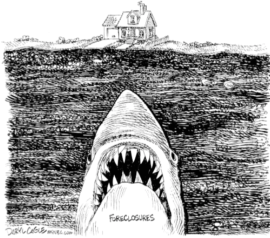
This fourth report, *The Widening Chasm Between Words and Deeds*, focuses on loan counselors' experiences in September 2008, a time when government officials, industry associations, and individual companies were continuing to represent publicly that great strides were being made to help borrowers in distress. Sadly, after much public discourse surrounding the need for a $700 billion federal financial bailout and its underlying cause—the foreclosure crisis—this new survey demonstrates that while the situation for borrowers has improved somewhat, loan servicers continue to fail to meaningfully address the crisis, as follows:

- Servicers are not modifying home loans at scale;
- Servicers are not conducting sufficient outreach to borrowers facing rising payments;
- Servicers continue to turn to foreclosure as their most common response to borrowers in distress; and
- Federal, state and industry initiatives that rely on voluntary industry compliance are not working.

The California Reinvestment Coalition hopes these reports will inform the public dialogue around foreclosure prevention and loss mitigation, and will promote sound policies and business practices that will help preserve homeownership and wealth in California communities.

This report was prepared by Kevin Stein, with valuable edits and assistance from Alan Fisher, Kimberly Jones, Victoria Leon Guerrero, Tram Nguyen, Jon Blas and Cometria Cooper. CRC would like to thank Christi Baker (Chrysalis Consulting), Maeve Elise Brown (Housing and Economic Rights Advocates), and James Zahradka (Law Foundation of Silicon Valley) for their helpful comments on earlier versions of this report. Any errors or omissions are those of the primary author.

California Reinvestment Coalition advocates for the right of low-income communities and communities of color to have fair and equal access to banking and other financial services. CRC has a membership of 250 nonprofit organizations and public agencies across the State.



The Widening Chasm Between Words and Deeds

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EXECUTIVE SUMMARY

> "Lenders say they can't help us because they can't contact us. We are here, trying to save our homes." *Jaime Silahua before several hundred homeowners attending a rally at Holy Rosary Church in Antioch, organized by Contra Costa Interfaith Supporting Community Organizations (CCISCO)*

> "We have experienced that lenders and servicers would rather let the homes go into foreclosure than to try to work something out." *A housing counselor in CA*

California documented foreclosure filings on 69,548 properties in September 2008, the highest in the nation. Additionally, six of the nation's top ten foreclosure rates were in California.[1]

This report is the fourth in a series that examines the extent to which home loan servicers are modifying loans and working with borrowers to preserve homeownership, as servicers say they are doing.[2] **Sadly, since the last report, not much has changed**. CRC conducted this survey of 44 mortgage counseling agencies and legal service offices statewide to determine the level of assistance servicers are offering borrowers now, and whether things have improved since the last survey in April 2008. As in April, counselors reported similarly frustrating experiences in the past five months trying to negotiate good outcomes for their clients. **For the month of September 2008, counselors again report that the most common outcome for borrowers is foreclosure**.

A series of government initiatives and industry commitments to follow "best practices" to avoid foreclosure have been announced over the past year. But the crisis is only worsening in California. These initiatives and best practices suffer from failing to be sufficiently ambitious in scope, and in relying on industry groups to voluntarily comply. Home loan servicers are subject to virtually no obligations, no accountability, and no transparency when it comes to helping

[1] "Foreclosure Activity Decreases 12% in September," Realtytrac, October 23, 2008. The six California metro areas in the top ten nationally of communities most impacted by foreclosure were: Stockton (#1), Riverside-San Bernardino (#3), Bakersfield (#4), Sacramento (#7), Fresno (#9), and Oakland (#10).
[2] The other "Chasm between Words and Deeds" reports can be found at www.calreinvest.org.

working families avoid foreclosure. More of the same from government and industry is simply unacceptable.

California housing counselors confirm that more needs to be done. Key findings include:

1. California Families and Communities Are Being Devastated by the Foreclosure Crisis.

- **Most borrowers are experiencing devastating outcomes, with foreclosures most common**. 52.5% of counseling agencies reported that foreclosure is still a "very common" outcome for their clients seeking assistance, compared to only 26.3% observing that loan modifications are very common. Long-term, sustainable loan modifications are the best solution for homeowners in distress.

- **Borrowers are facing profound economic challenges.** Large majorities of counseling agencies report they are working with borrowers who are:
  - "under water" (owe more on their loans than their homes are worth) (97.2% of agencies report this is very common);
  - experiencing a decrease in family income (85.7%);
  - stuck with option ARM loans that leave them owing more than when they started (82.9%);
  - struggling with unaffordable loans that never should have been made (73.2%);
  - realizing that key loan terms promised in their Spanish and Asian language negotiations didn't find their way into English-only documents (64.3%); and
  - victims of broker or lender fraud (56.1%).

- **The huge numbers of Californians who are under water need loan principal reduction, but that relief is rarely available.** A toxic combination of inflated appraisals, option ARM loans, and an overheated housing market that abruptly tanked has left many families owing much more money than their homes are worth. Not one counseling agency reported that principal reductions—often the key remedy for such borrowers—are very common.

- **Tenants are harmed by foreclosure.** 31% of agencies reported that tenants living in foreclosed homes are very common, and another 28.6% reported this situation as somewhat common. Tenants are the most unwitting victims of this crisis. They are often the last to know that the bank has foreclosed on their landlord; victims of illegal eviction attempts; subject to utility shut-offs; and forced to leave without recovering their security deposits. Greater protections are needed to help these families avoid homelessness.

- **Distressed homeowners are turning to expensive payday loans.** In a disturbing sign of these desperate times, one-third of counseling agencies reported that homeowner clients have taken out high-cost payday loans which often carry Annual Percentage Rates of

460%.

II. Servicers are Not Reaching Out and Modifying Loans.

- **Lenders are not responsive**. 93.6% of groups responding said that the industry as a whole is not consistently modifying loans for long-term affordability, subjecting borrowers to future difficulties as payments rise once more.

- **Longer-term loan modifications still lag.** Counseling groups were most likely to respond that when servicers were willing to modify loans, they were only willing to fix interest rates for one or two years at a time. These short-term solutions will make future payments difficult and may ultimately lead to foreclosure.

- **Outreach to borrowers in trouble is poor**. 63.6% of groups responding reported that the industry as a whole is NOT conducting outreach to borrowers before rates and monthly payments increase. Even where servicers are reaching out to borrowers before delinquency, counseling agencies report in large numbers that servicers remain unwilling to restructure loans for borrowers before they fall behind on payments. This finding is especially troubling given that both federal and state servicer agreements, in which all of the servicers in the survey participate, commit the servicers to work with borrowers before they are in default.[3] Only one agency reported that the industry as a whole was working with borrowers before default. Individual servicers did not fare much better.

- **Servicers are still 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 23 companies were named as servicers that are difficult to work with. Wachovia was named most often, with 14 groups citing Wachovia/World as difficult to work with. Next came Wells Fargo and Ocwen, which were named by 9 groups.

- **Servicers may have a financial incentive to foreclose**. Servicers say it's not in their interest to foreclose, but that may not be the case. Foreclosure is often the least troublesome solution for servicers: 1) in a foreclosure the servicer gets paid; 2) foreclosure avoids the possibility of the servicer getting sued for exceeding its authority by modifying loans; and 3) foreclosure can help garner a better rating agency grade since the system rewards those who extract the most cash, which is more safely done through foreclosure.

- **Counseling agencies are frustrated**. Counseling agencies continue to express frustration

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[3] California Subprime Loan Agreement, November 21, 2007 (http://www.corp.ca.gov/press/news/SubprimeLending.asp) and "HOPE NOW Hails Broad Effort to Refinance and Modify Mortgage Loans," HOPE NOW press release, December 6, 2007, available at www.hopenow.com.

with companies that do not offer any real solutions and provide poor customer service. Below is a sampling of comments made by counseling agencies. (The full text of all comments submitted is set forth in Appendix I.)

- "Lack of concern, lack of urgency, lack of sense of timing, although they set the time frame. Failure to stop foreclosure long enough to negotiate and process requests."
- "All have taken months to make a decision... had us on hold for 2.5 hours and then a machine came on stating that they were now closed and cut us off. On average 30 minutes to get to the right person, but before that we could be talking to 2 to 3 different depts or reps before we get to the right person."

III. Federal and State Initiatives Are Not Working.

- **HOPE NOW questioned.** The most significant federal efforts to prevent foreclosures have centered on the HOPE NOW alliance, a coalition of mortgage servicing companies, trade groups and counseling agencies. Counseling agencies report that servicers have not met any of the benchmarks established five months ago by HOPE NOW's Mortgage Servicing Guidelines, designed to encourage more timely responses to borrowers.[4]

- **State efforts questioned.** Counseling agencies report starkly longer wait times to reach a servicer than data reported by the Department of Corporations would suggest.[5]CRC also questions the purported success of the Governor's year-old Subprime Loan Agreement, as well as the prospects for success of his new proposal to offer servicers the choice of developing a streamlined loan modification program or a 90-day stay on foreclosures. A lack of enforcement and public data reporting threaten to undermine both proposals.

- **Fannie Mae and Freddie Mac: part of the problem or the solution?** Counseling agencies responding to the survey were slightly more likely to report that both Fannie and Freddie-serviced loans were more difficult, as opposed to less difficult, to modify than loans not subject to Fannie Mae or Freddie Mac guidelines. As the U.S. Government is now essentially in control of Fannie and Freddie, it is imperative to ensure that both companies are aggressive in helping families maintain homeownership.

- **A slew of additional federal efforts have failed to adequately address the foreclosure crisis.** The Paulson "Teaser Freezer" Plan, Project Lifeline, FHA Secure, and Hope for Homeowners have all failed to live up to expectations. Even the $700 billion bailout adopted by Congress has gone from a program that would buy up distressed mortgage assets in order to reduce foreclosures and encourage lending, into one focused on capital injections into many of the banks that caused this crisis in the first place, merely enabling

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[4] See http://www.hopenow.com/upload/press_release/files/Mortgage%20Servicing%20Guidelines.pdf.
[5] DOC collects data on state-licensed servicers. Counseling agencies responding to this survey are attempting to contact state-licensed and federally-chartered servicers.

them to buy other banks.[6]

- **One cause for optimism – FDIC**. Under the leadership of Chair Sheila Bair, the FDIC has been promoting more streamlined loan modifications and has informed the Bank of America predatory lending settlement, the recent JPMorgan Chase initiative, and Governor Schwarzenegger's recent plan. Indymac Federal Bank performed relatively well in this survey, though there were complaints. All of these FDIC-inspired initiatives must be subject to scrutiny in order to ensure success.

RECOMMENDATIONS

What we have in place is not working. In order to keep borrowers in their homes, and to address the concerns of housing counseling agencies and legal services offices, CRC urges lenders, the California Legislature, Governor Schwarzenegger, federal banking regulators, Congress and the Bush and Obama Administrations to take the following key steps:

- **Stop foreclosures**. Impose a 180-day moratorium on foreclosures to allow enough time for workouts to occur and to halt the downward spiral of property values, while homeowners make affordable payments. Impose foreclosure filing fees to mitigate against financial incentives servicers have to foreclose, and to create a foreclosure prevention fund.

- **Modify loans**. Mandate that all servicers adopt FDIC-like streamlined, long-term loan modification programs. These programs should include principal reduction, help borrowers who are in default as well as those current on their loans but struggling, and allow borrowers to opt for mediation to ensure negotiations are fair and productive.

- **Create accountability**. Loan servicers must be required to submit detailed loss mitigation data to regulators that is validated and subject to public review. This is the only way to truly inform policymakers and the public as to what is going on, and to encourage better business practices by subjecting those practices to the light of day.[7]

- **Reform the Bankruptcy Code**. Change the Bankruptcy Code so that judges are permitted to modify loans on owner occupied housing, as can be done for 2nd lien loans, boat loans, and other less compelling credit products. The Center for Responsible Lending estimates that this change could help 600,000 people avoid foreclosure.

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[6] Michael J. de la Merced, "Many Line Up for Cash, but Bailout Plan Falters," New York Times, November 14, 2008.

[7] Citibank voluntarily reports some of this data on its website, throwing into serious question industry arguments that these data are private or contain trade secrets.

- **Reform the lending system**. The abusive and predatory lending practices that placed borrowers into high-risk loans and fueled our current crisis should be outlawed, investors held liable for any such abuse, and borrowers given a clear and meaningful ability to vindicate their rights in court.

- **GSE (Government Sponsored Enterprise) Reform**. Require Fannie Mae and Freddie Mac to aggressively pursue long-term loan modifications as servicer and investor; encourage low-cost home lending, especially in areas hard-hit by foreclosures; and support affordable housing development, which is critically needed, and which is being adversely impacted by Fannie and Freddie's retreat from the Low Income Housing Tax Credit market.

SURVEY OF HOME LOAN COUNSELING AGENCIES: FINDINGS

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 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 prevention and post-purchase counseling. The 44 groups that responded to this fourth CRC survey served 11,630 consumers during September 2008, which is equivalent to 16.7% of all Notices of Default filed that month. The groups collectively saw 2,938 more clients in September 2008 than they did in April 2008, confirming that things are only getting worse for homeowners, and that counseling agencies are filling a need unmet by industry and government.

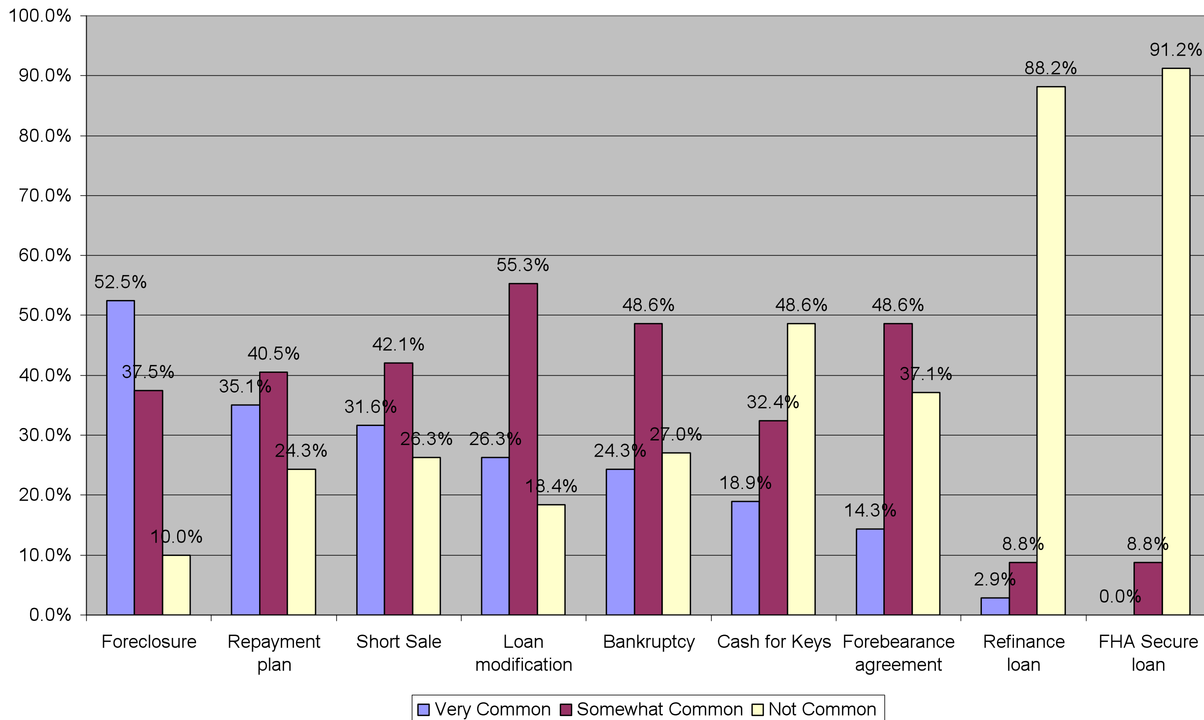
As with the last survey, the state's largest servicers and those that signed on to the Governor's Subprime Loan Agreement[8] were selected for consideration: Bank of America/Countrywide, Carrington, Citibank, GMAC, HomEq, HSBC, JPMorgan Chase, Litton, Merrill Lynch (Wilshire, HLS), Ocwen, Option One/American Home, Washington Mutual, Wachovia/World Savings and Wells Fargo. This survey also included Indymac Federal Bank, FSB, recently taken over by the FDIC. A category of "all lenders" was again included to survey counselors on their impressions of industry performance as a whole.

The California housing counseling agencies surveyed confirm that more needs to be done to help borrowers at risk of foreclosure.

I. Impacts on Borrowers and Communities Are Severe.

[8] For a description of the Governor's Subprime Loan Agreement, which was designed to promote loan modifications for borrowers facing unaffordable interest rate resets, see www.corp.ca.gov/press/news/SubprimeLending/asp.

A. Borrowers are experiencing devastating outcomes. Counseling agencies were asked how common the following different loss mitigation outcomes were for their borrowers: loan modification, repayment plan, forbearance agreement, loan refinance, FHA Secure Loan, short sale, foreclosure, bankruptcy, cash for keys, or "other." Despite a slight decline in the number of agencies reporting foreclosure as most common, the responses to this critical question were almost as bleak as those a few months ago.



- *Foreclosures still lead*. Groups were still most likely to report foreclosure a "very common" outcome for borrowers. 21 groups, or 52.5% of those reporting, said that foreclosures are a very common outcome for their clients. This was slightly lower than the 68% of respondents so reporting five months ago. An additional 37.5% of respondents said that foreclosure was "somewhat common" for clients, while only 10% said foreclosure was "not common." This finding is consistent with a recent report by state Attorneys General which found that 8 out of 10 seriously delinquent homeowners were not on track for any loss mitigation outcome.[9]

[9] State Foreclosure Prevention Working Group, "Analysis of Subprime Mortgage Servicing Performance," Data Report No. 3, September 2008.

- *Repayment plans are next*. 13 groups, or 35.1% of those reporting, cited repayment plans as a “very common” outcome for borrowers. Repayment plans can be helpful to borrowers, but in most cases they require already overburdened homeowners to pay additional amounts to bring their payments current.

- *Short sales hold steady.* 12 groups, or 31.6% of respondents, cited short sales—where servicers minimize their losses by allowing homeowners to sell their property for less than the amount of money owed—as a “very common” outcome for borrowers, roughly the same as in April 2008.While preferable to foreclosure, short sales still leave the borrower without a home or any equity, may result in a higher tax bill, and require the assistance of competent real estate and legal professionals. Disturbingly, legal service offices report seeing “short sales” where servicers are asking borrowers to sign promissory notes that obligate them to pay the difference between the amount previously owed and the sales price.

- *Loan modifications are not very common*. Only 10 agencies—just over one quarter of those responding—said that loan modifications were a “very common” outcome for borrowers, which is one more than the 9 groups reporting this outcome in the last survey. Long-term loan modifications are the best outcome for borrowers wishing to remain in their homes. A respectable 55.3% of respondents said that loan modifications were “somewhat common,” up from the 44.7% who responded likewise in April.

- *Refinance loans, especially the FHA Secure product, were not meaningful options for clients.* Only one group reported that refinancings were a “very common” outcome for borrowers, and zero groups reported FHA Secure as “very common.”Further, only 3 groups reported refinance loans and FHA Secure as “somewhat common,” while the bulk of respondents reported that both refinance loans and the FHA Secure product were not common at all. That FHA Secure, touted as the federal government’s response to the foreclosure crisis, has not worked is a cause for concern.

Counselors Speak:

- “Repayment plans most often do not work because they typically increase the monthly payment; they seem to be done hastily, just so the servicer can report that they have ‘done x # of modifications.’ Foreclosure is the most common outcome, followed by modifications that lower the interest rate. We have only seen one principal reduction on a first mortgage and that just happened at the end of September ‘08.”

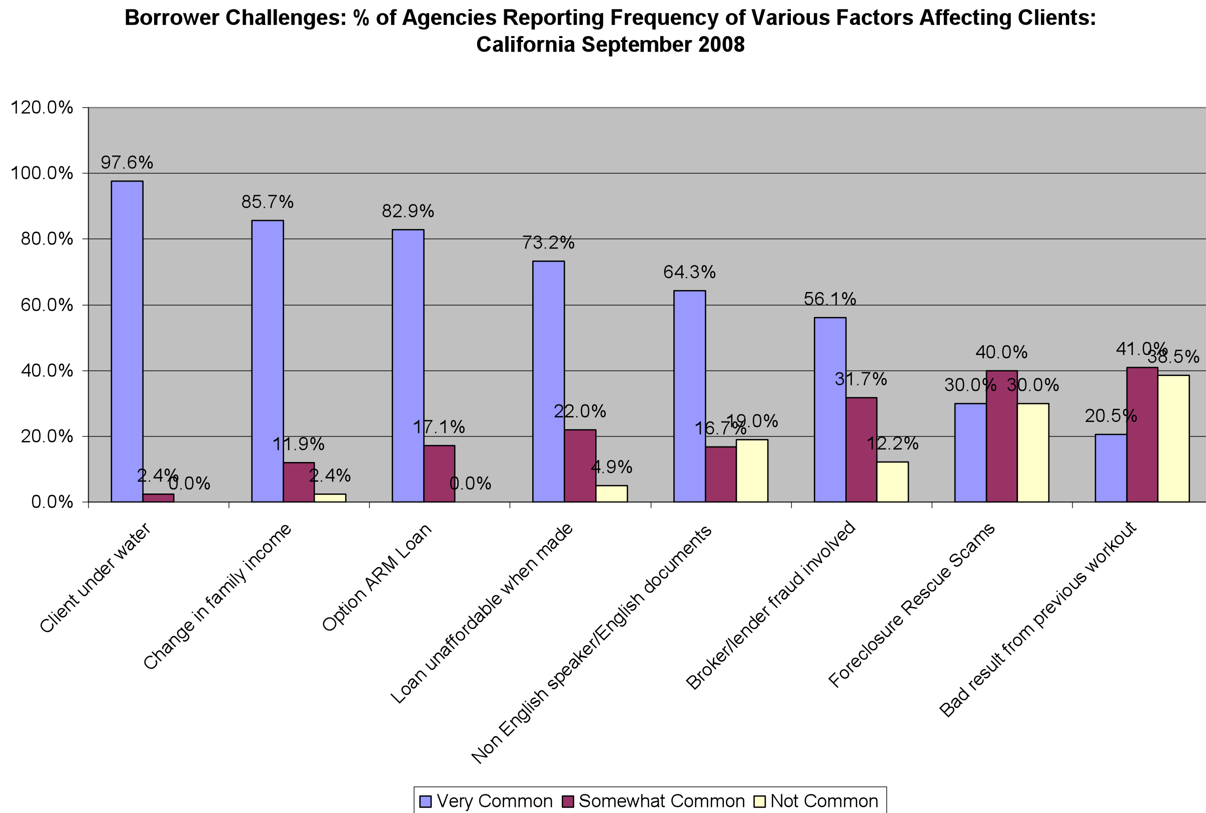
- “Right now with our current pipeline of foreclosure clients, we are waiting for responses from servicers, which are now at the 4th or 5th month, even with constant follow-up.”

- “Public needs to be made aware that an actual modification is not that easy to get. It is

more common that they will be offered something other than a modification."

- "We have experienced that lenders and servicers would rather let the homes go into foreclosure than to try to work something out."

B. Families are facing profound economic challenges. Counseling and legal service agencies were asked to assess the circumstances that led their clients to come to their offices seeking assistance. The results were sobering.



- *Declining home values have left the vast majority of borrowers "under water" and with few options*. Perhaps the most striking finding in this survey is that nearly every counseling agency responding (97.2%) stated that it was very common for clients to owe more money on their home loans than their homes were worth. Not one group reported that this was not an issue for its clients. This leaves borrowers with few positive options, as refinancing and selling one's home become infeasible. Rapidly declining home values and increasing mortgage debt have overwhelmed California borrowers and communities. Principal write-downs are what families in this state need to maintain homeownership. Over a quarter of California homeowners may be upside down.[10]

- *Family incomes are not keeping pace with mortgage payments*. Increasingly,

[10] Les Christie, "7.5 million homeowners 'underwater'," CNN Money.com, October 31, 2008.

California families are unable to keep up as incomes decrease. 85.7% of groups responding cited “change in family income” as a reason why clients are in trouble and seeking help. Only one group reported that this was not a common occurrence. The faltering economy is having an impact on foreclosures in our state. Americans filed 106,266 bankruptcy applications in October 2008, up 40% from last year and up 20% from September.[11]

- *Option ARM loans haunt the state*. A large 82.9% of responding agencies report that option ARM loans are a very common occurrence for clients. Option ARM loans, which allow borrowers to choose to make a negatively amortizing payment which only increases the amount of money owed on the loan, were sold aggressively by brokers and lenders to California borrowers for whom the loan was not at all suitable. These complex loans were not easily understood by, or affordable to, many borrowers. Combined with falling home values, option ARM loans put borrowers deeply under water. Fitch Ratings estimates that $200 billion in option ARM loans are outstanding, $96 billion of which will recast to substantially higher monthly mortgage payments in the coming two years.[12] Much of the devastation will occur in California.

- *Industry standards were loose, at best*. A very large 73.2% of respondents reported it was “very common” for their clients to have received loans that were unaffordable to them at the time the loan was made. 30 groups responded this was a very common problem, while 2 additional groups reported this was somewhat common. Only 2 groups said this was not common.

- *Industry fraud and abuse of immigrants are substantial concerns*. A growing chorus (64.3% of responding groups) reported that non-English speakers were sold loans in their native language, but provided English-only documents. This is a recipe for abuse, and flies in the face of California state law requiring translation of certain documents in certain transactions.[13] Similarly, 56.1% of groups responding cited lender/broker abuse as a very common problem.

Counselors Speak:

- “Common reasons: Job loss, divorce, work injury/illness with no disability insurance.”

- “Non-English speaker/English docs 100% of the time.”

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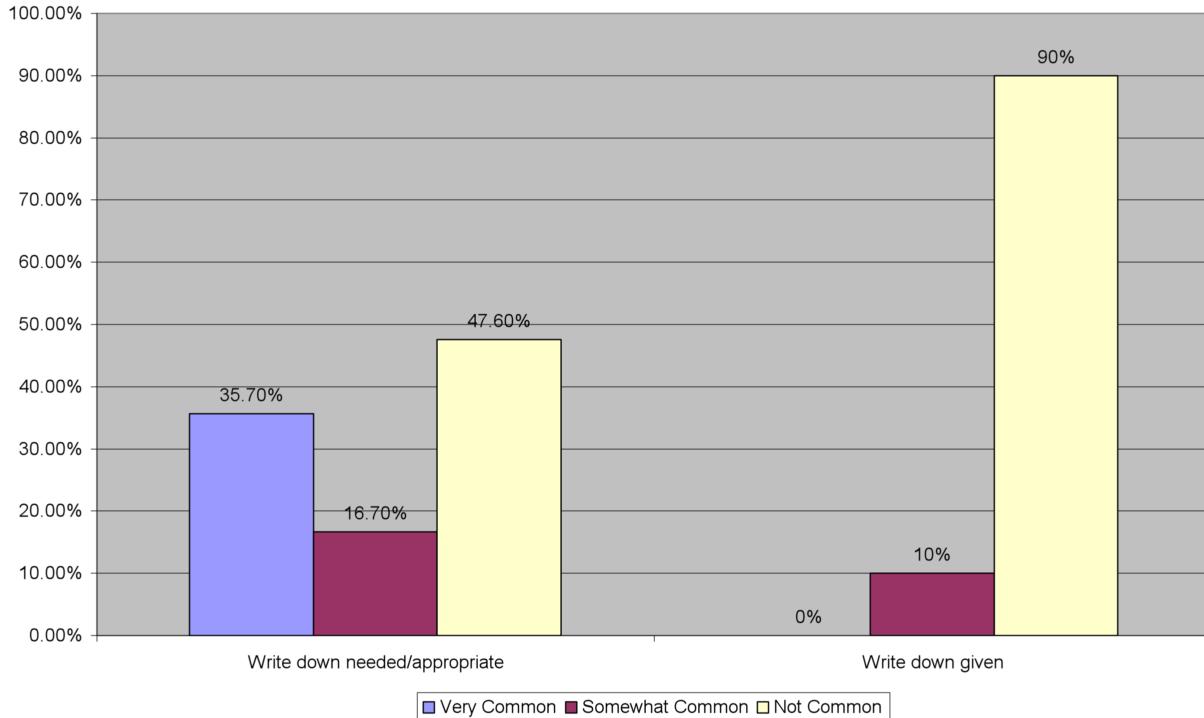
[11] Chelsea Emery, “US consumer bankruptcies soar in Oct; see record,” Guardian, November 4, 2008.
[12] Fitch Ratings, “Option ARMs: It’s Later Than It Seems,” Structured Finance, Residential Mortgage Special Report, September 2, 2008, www.fitchratings.com.
[13] California Civil Code §1632.

- “Paperwork at close of loan so extensive that borrowers can't read everything and rely on the loan agent/broker to be honest and that loan terms are what they were represented to be. Many who say the loan was unaffordable when made did not understand the terms of the loan, and on stated-income loans often agent/broker inflated the income without borrower knowing, also did not understand neg am loans.”

C. Though needed to aid an increasing number of California households who owe more than their homes are worth, principal write-downs are not happening. With borrowers owing more than they can afford at the same time housing values have plummeted, principal write-downs are needed. This is especially true in California, where so many loans were unaffordable at origination, housing values have plummeted, and option ARM loans were sold aggressively and inappropriately, trapping many families in unsustainable negatively amortizing loans. All of these factors have left many California families owing more than their homes are worth and in need of principal reductions.

Indeed, loan modifications that include principal reduction are more likely to succeed in keeping borrowers in their homes and making modified payments.[14] Principal modifications not only reduce the monthly payment for homeowners, but also reduce the amount of money owed beyond the value of the home. This means that principal reductions can increase both the ability and the willingness of homeowners to make payments.[15] Worthy of note is Ocwen, which has ramped up efforts to do principal reduction modifications. Ocwen accounts for 70% of the total principal mods, according to Credit Suisse.[16]

[14] Rate freeze and principal reduction modifications have re-default rates less than half of those for more traditional mods. Credit Suisse, “Subprime Loan Modifications Update,” October 1, 2008.
[15] Id.
[16] Id.



- *Counselors report that principal write-downs could aid a number of clients*. 52.4% of agencies responding said that the need and appropriateness for a principal write-down were a very common or somewhat common occurrence.

- *Write-downs are virtually nonexistent*. No group reported that principal write-downs were a very common occurrence, while only 4 groups reported it as a somewhat common occurrence. A whopping 36 groups reported that principal write-downs are not common.

Counselors Speak:

- "LOL! God only knows what these servicers/investors are waiting for! The greater depression of 2008? They are still digging their heels in, but the recent movement by the FDIC-owned IndyMac, Countrywide and FHA H4H is a huge step in the right direction. Let's see if other lenders will follow suit and how many H4H actually get originated..."

- "Writing down the principal would help all clients stay in the home and would slow down the amount of foreclosures currently taking place. This would be a good step towards halting the high number of foreclosures occurring everyday. It is a much-needed remedy. These homes' prices should have never reached these levels and because of

greed, and deregulation, it created an environment in which we find ourselves today."

- "We have noticed write-downs only when a lawsuit is filed."
- "Most of our clients have some income and can sustain a mortgage if they reduce principal."

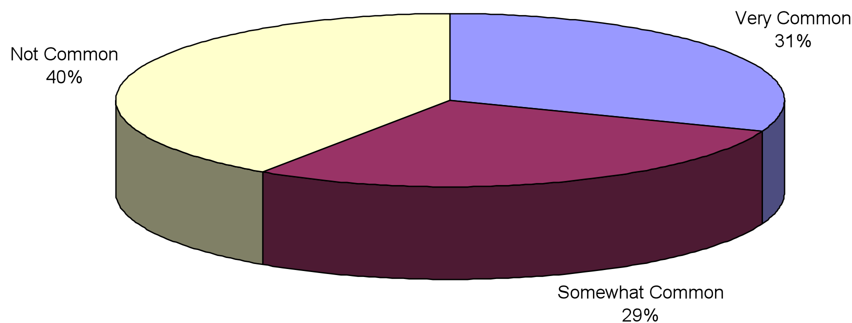
D. Broader impacts: innocent victims. In addition to homeowners, tenants whose landlords have distressed loans are being greatly impacted. They are perhaps the most forgotten and compelling victims of all in the foreclosure crisis. Often tenants who have been faithfully paying their rent for years will suddenly find that the property has been foreclosed upon, and they are being forced to leave their homes. CRC is concerned that tenants are being harassed and illegally evicted, forced to live in uninhabitable conditions (no water, no electricity), and denied the return of their security deposits. Instead, these tenants could be allowed to remain in foreclosed homes while these properties await a new owner, which would benefit tenants, lenders and communities, but banks have been resistant to this idea. Interviews with tenants' rights groups throughout the state suggest that these problems are real and severe.

All groups interviewed said that tenants are often unaware of their rights. This is a significant problem because it may lead tenants to react out of fear or ignorance of the law, neither of which leads to good results. Industry practices by banks and third parties aggravate this problem, leading to constructive eviction of many tenants without proper notice due to this fear. Harassment of tenants in foreclosed homes to induce them to leave is pervasive. Some tenants' rights groups report a huge problem with utilities being shut off, sometimes for months, while tenants are living in the foreclosed home. Utility companies, caught off guard by the impact of the foreclosure crisis, are focused on making sure the outstanding bill is paid and have been slow to make changes that allow tenants to keep their utilities on.

The foreclosure crisis impacts a broad spectrum of tenants. The hardest hit are immigrant communities, poor and working families, the elderly, and persons with disabilities. Persons with disabilities are particularly affected, because they may not be able to easily find new homes with ramps, that allow guide dogs or provide other needed and reasonable accommodations. A utility shut-off for a person dependent upon electricity to power up a wheelchair or a person dependent upon medication that must be refrigerated poses serious health issues that must be addressed. Finding affordable housing is already a problem for people who are on limited income and receive SSI or other forms of government assistance.[17]

[17] The anecdotes in this section are based on interviews conducted by Cometria Cooper with tenants' rights groups in various part of California, Fall 2008.

Prevalence of Tenants: % of Agencies Reporting Frequency of Tenants in Affected Properties: California September 2008



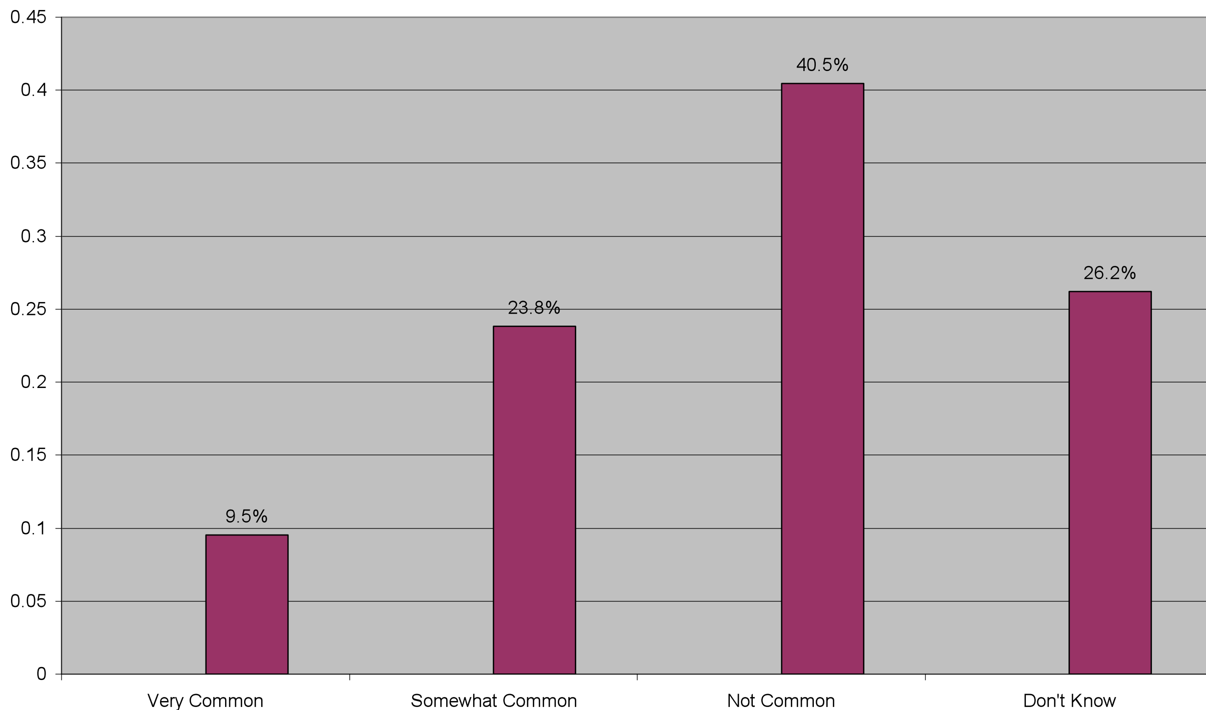
- *Tenants are living in many distressed homes*. A majority of responding agencies said that tenants are a very (31%) or somewhat (29%) common presence in properties they are trying to save from foreclosure.

Counselors Speak:

- "At least 90% of our clients have tenants living in their homes in order to sustain income."
- "HOPE and lenders are suggesting this [homeowners should take in tenants] if mortgage is unaffordable."
- "We have several calls from tenants who are living in foreclosing properties."

E. Distressed homeowners turn to expensive payday loans, digging themselves a bigger hole. As bad as the foreclosure numbers are, the numbers may be masked by households borrowing on ever-more-expensive terms to make their monthly mortgage payments. An

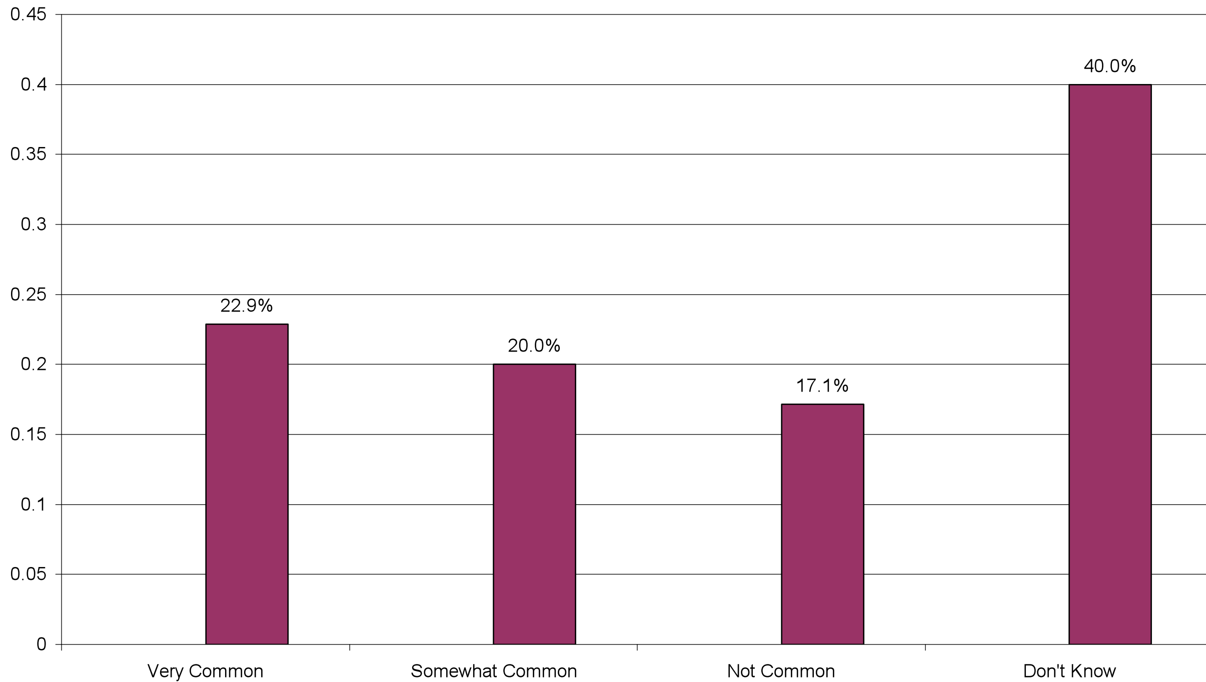
egregious example is where homeowners take out payday loans—short-term consumer loans taken out against a future paycheck with Annualized Percentage Rates of 460%—to pay their mortgages or other debts. As the economy worsens, access to loans continues to shrink, and more and more families struggle to keep their jobs and maintain their incomes, this may become a larger issue.



- One-third of responding agencies stated that it was “very common” or “somewhat common” for their clients to also take out payday loans.
- An additional 26.2% of agencies were unsure whether their clients took out payday loans, possibly because they did not ask for or track this information.

Counselors Speak:

- “We ALWAYS STRONGLY advise them against this!!!!”
- “More common to borrow from IRA accounts and deplete savings.”
- “Low-income &first-time homebuyers fall into this. FORMERLY higher-income clients pay with credit cards & many have had limit cut.”
- “It is more common for borrowers to take credit card cash advances or borrow from friends/family putting them further into debt.”



- Looking only at clients who took out payday loans, 22.9% of agencies reported that it was very common for these borrowers to use payday loan proceeds to make their monthly mortgage payment.

- Another 20% of agencies reported that this was a somewhat common occurrence.

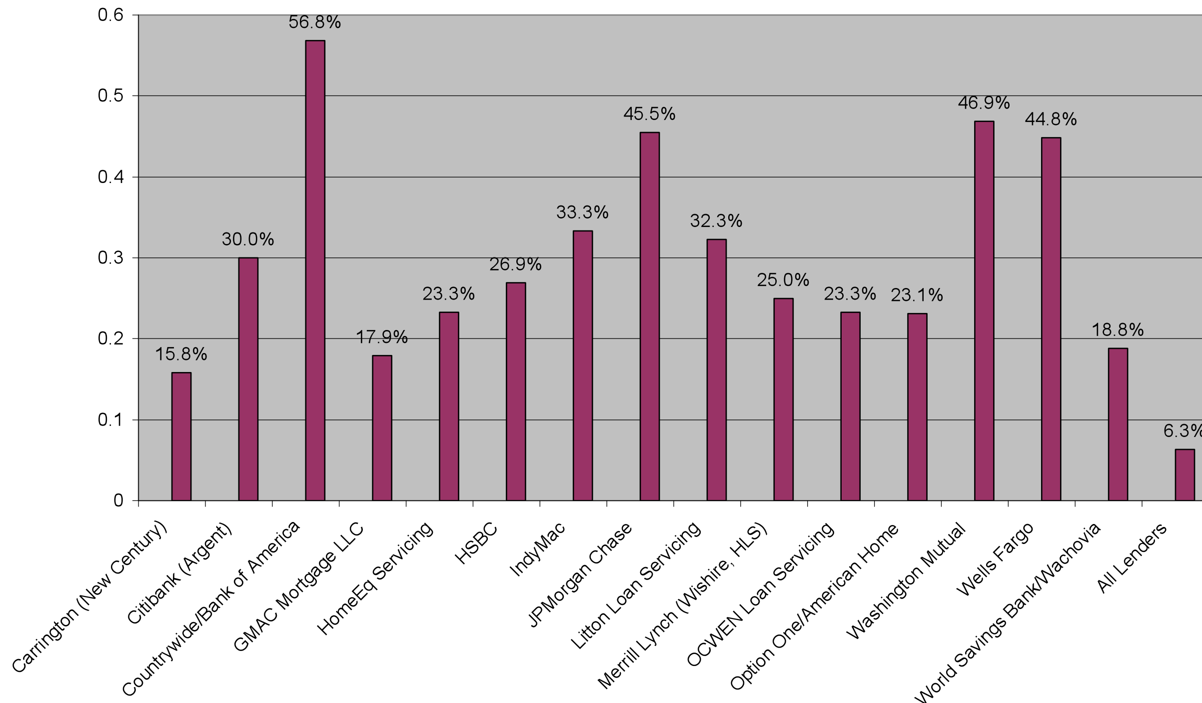
Counselors Speak:

- "Once the advances start, it is hard to get off the cycle."

II. Servicers Are Not Reaching Out and Modifying Loans.

A. Lenders are not responsive. Agencies were asked if particular servicers, and the industry as a whole, consistently modify loans by fixing interest rates for the life of the loan.

Long Term Loan Modifications: % Respondents Reporting Servicers are Offering Long Term Loan Modifications: California September 2008



- *No long-term loan modifications*. 15 groups responded that the industry as a whole is not consistently modifying loans for long-term affordability. Only one group reported that the industry as a whole was modifying loans for the long term.
- *Worst performer*. As in the last survey, Carrington received the lowest marks. Only 15.8% of respondents reported that Carrington was modifying loans for the long term.
- *Best performer*. Bank of America/Countrywide was the only servicer to show a majority of respondents (56.8%) stating it was modifying loans for the long term. Washington Mutual, JP Morgan Chase and Wells Fargo were the next-highest performers.

Counselors Speak:

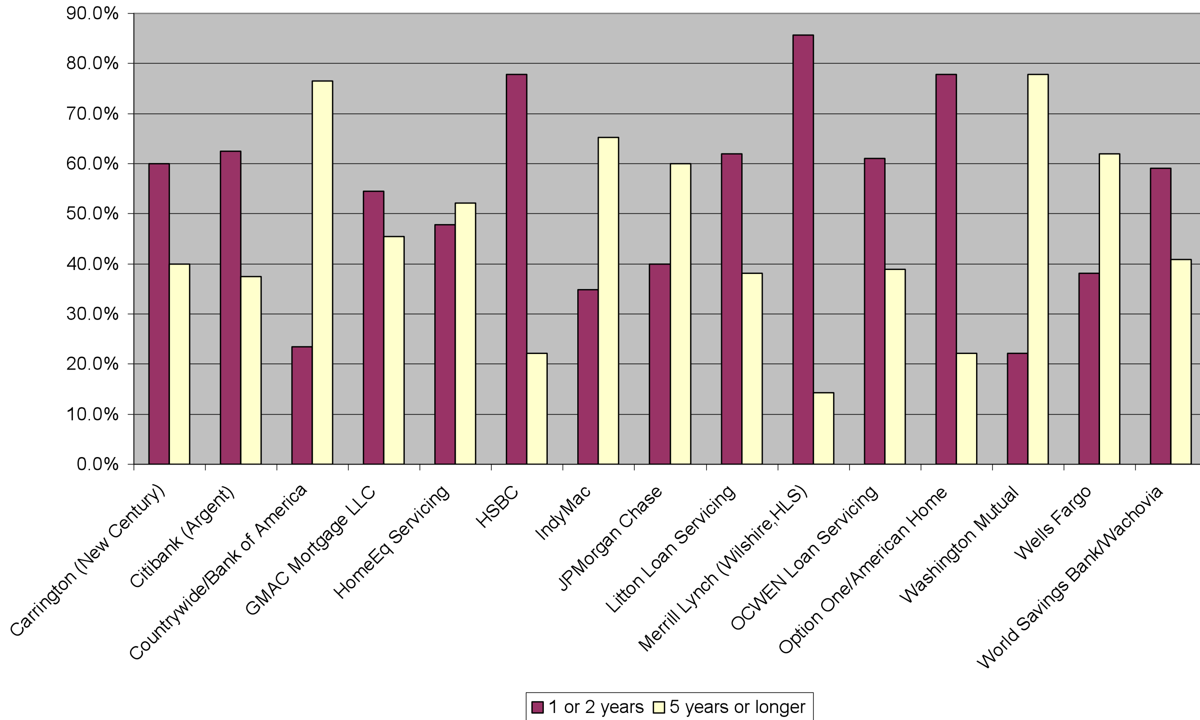
- "Too many servicers are still opting for the 5-year band-aid approach; not helpful. None of us want to be doing this in 5 years. Moreover, lenders have been loath to write down principal balances so that we can get the homeowners to a 38% housing ratio (PITI+HOA) based on actual household income."

- "Too long is being taken to reach a decision. They are offering modifications that are only a short-term solution but nothing in the long term."

- "We have no teeth; being at their mercy is ridiculous. No two agents from the same company ever say the same thing. What a circus."

- "It is hard to say that any lenders consistently modify loans. Many often do but on a case-by-case basis. Frequently the loan mods that are offered are not accepted by borrower because the payments are not affordable and therefore are not sustainable for the long term."

B. Longer-term loan modifications still lag. In general, responding agencies still are more likely to say that loans are modified for only 1 or 2 years, as opposed to 5 years or longer, though the gap is narrowing. 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 when servicers were willing to modify loans, they were only willing to fix interest rates for one or two years at a time. This was true for 9 of the 15 servicers considered in the survey. Rather than provide a sustainable solution for borrowers in distressed loans, servicers offer short-term modifications of 1 to 2 years, which only delay the problem. These short-term solutions are like giving borrowers new adjustable rate loans which will make future payments difficult and may ultimately lead to foreclosure.

- *Worst performers*. Only 14.3% of responding agencies reported that Merrill Lynch was willing to modify loans for 5 years or longer. Also performing poorly were HSBC and Option One/American Home; 22% of responding agencies reported these two servicers were willing to modify loans for 5 years or longer.

- *Best performers*. Over three-quarters of groups responding reported that Washington Mutual (78%) and Bank of America/Countrywide (77%) modify loans for 5 years or longer when they modify loans. Counseling agencies were also likely to report that Indymac (65%), Wells Fargo (62%), and JPMorgan Chase (60%) were likely to modify loans for the long-term. JP Morgan Chase, Washington Mutual and Bank of America/Countrywide were reported to be most likely to modify loans for more than 5

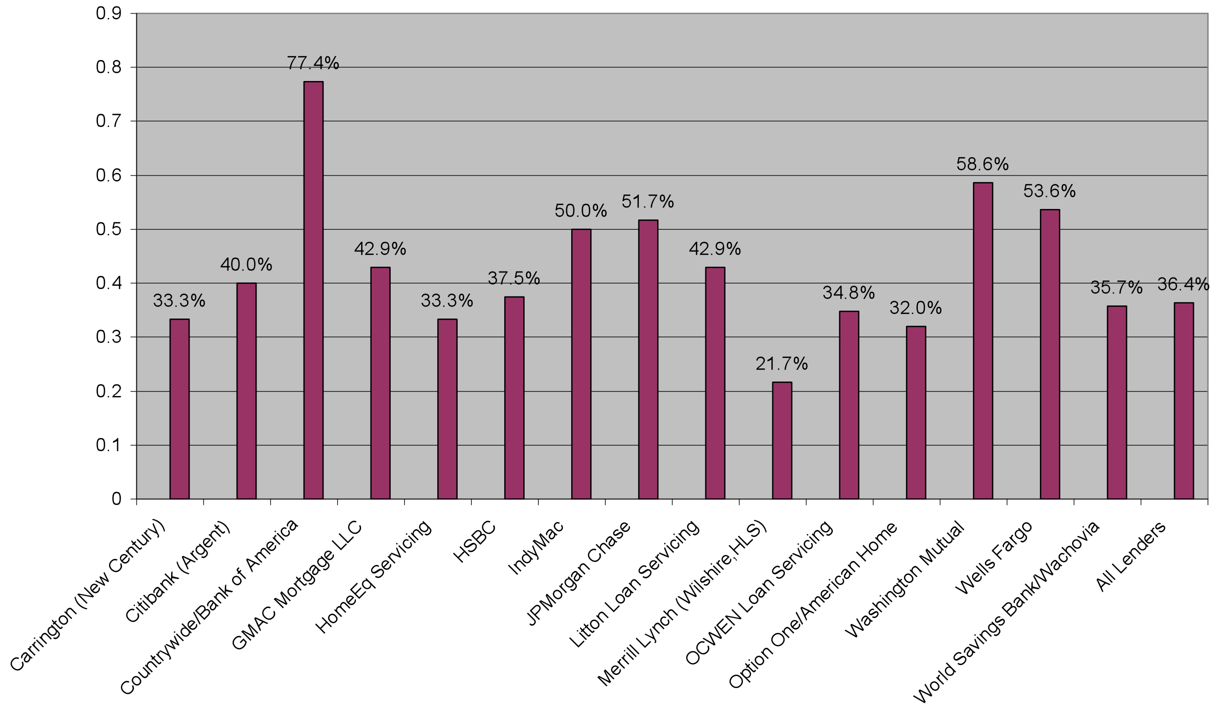
years when they modify loans.

Counselors Speak:

- "What they state on the phone isn't necessarily what the new loan docs say."
- "Most are offering 2-5 year fixed options."
- "Since we are not getting cooperation with banks, I cannot answer the above questions."
- "Many lenders put borrower on a payment plan for 3-6 months before they will consider loan modification to see if borrower can pay each month."

C. Outreach to borrowers in trouble is poor. Despite lenders' assertions about reaching out to borrowers BEFORE they face problems from rising interest rates and higher monthly payments, most counseling and legal service agencies do not see this happening. Most counseling agencies reporting noted that loan servicers were failing to conduct outreach prior to interest rate resets. A large 63.6% of groups responding reported that the industry as a whole was NOT conducting outreach to borrowers before rates reset.

A disturbing and continuing dynamic is that borrowers who affirmatively reach out to loan servicers BEFORE they are in default are often told they cannot be helped until they are in default. So, far from helping borrowers who are being proactive, loan servicers are often encouraging borrowers to fall behind on their payments, hastening foreclosures and ruining borrowers' credit.



- *No early contact*. For the industry as a whole, only 6 respondents, or 36.4% of those responding, said that in their experience, lenders were making contact with borrowers before delinquency. Though low, these numbers are slightly higher than those reported by groups in April 2008.

- *Worst performers.* Only 5 groups reported that Merrill Lynch was reaching out to borrowers before delinquency. Yet 18 respondents, or 78.3% of groups reporting, said that Merrill does NOT make contact with borrowers before default.

- *Best performers.* Bank of America/Countrywide outperformed its peers, with 77.4% of groups reporting that BofA does outreach to borrowers before default. Washington Mutual, Wells Fargo, JP Morgan Chase, and Indymac rounded out the list of servicers who were reported by most responding agencies to be reaching out before borrowers fall behind on their payments.

Counselors Speak:

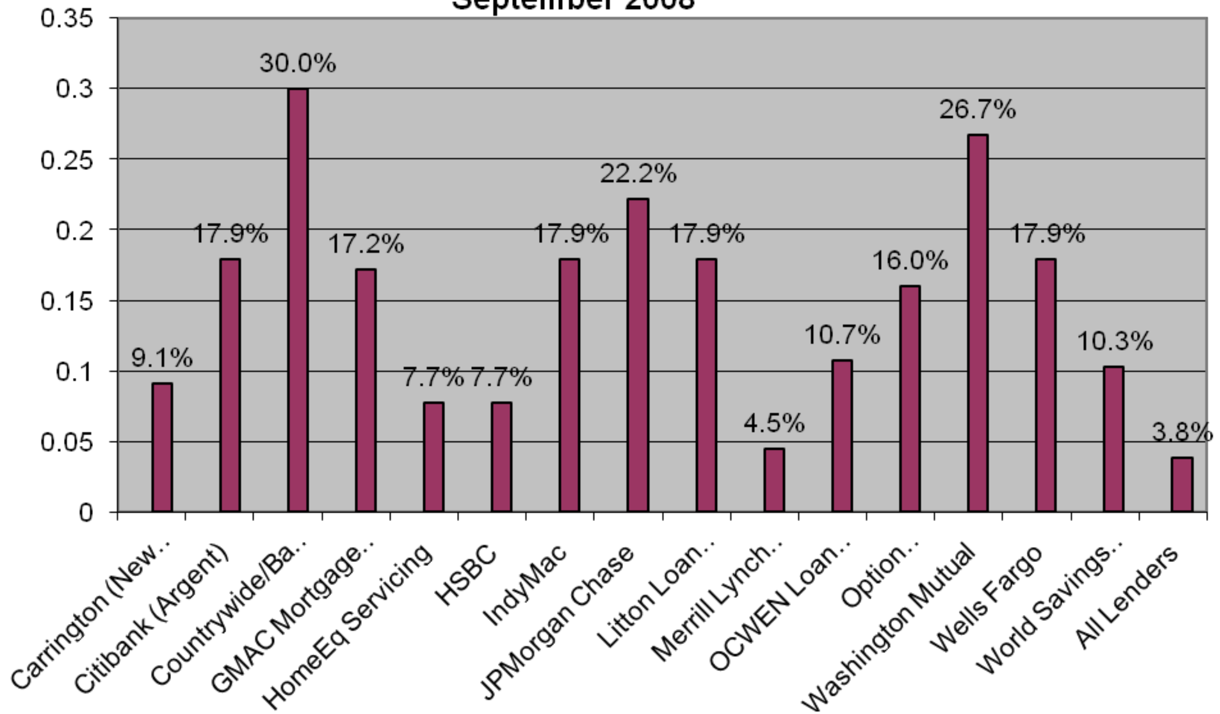
- "Follow through is the issue. Not just making contact! Calling the client back, providing

a call back # or email address. Follow through. Yes, it's a capacity issue, but it's still an issue. Big time. At least let the client know it will be 2-3 months before we get back to you..."

- "For the most part, most of our clients have been receiving correspondence, but a lot of the families are not sure what the information entails on top of which, all letters are in English. Secondly, as a housing counseling agency, these letters do nothing for us now, considering we've been working with foreclosure clients and getting out the word since the spring of 2007."
- "A 30-day notice that a person's payment will go up a couple of thousand dollars is not considered early to me. A payment going from $2500 to $5000 with a 30-day notice is not 'early' notice."
- "Most lenders are trying."
- "'Yes' answers pertain to written notices to borrowers prior to loan reset; [there are] no phone calls or personal contact of any kind. Past due or notice of intent letters sent to borrowers and collection calls [are] made, but contacts are mostly made by customer service/collection department. These representatives demand payment without discussing alternative options. Borrowers can seldom get through to someone who can discuss/offer alternative options. Letters that go out to borrowers that include contact info for housing counseling agencies are often not understood."

D. Servicers are unwilling to work with borrowers to prevent problems, regardless of whether they reach out to borrowers before delinquency. As with prior surveys, some of the lowest marks servicers received were in response to the question, "are lenders/servicers consistently willing to work with borrowers BEFORE they are in default?" This finding is especially troubling given the fact that both the federal and state servicer agreements, in which all of the servicers in the survey participate, commit the servicers to work with borrowers before they are in default.[18]

[18] California Subprime Loan Agreement, November 21, 2007, (http://www.corp.ca.gov/press/news/SubprimeLending.asp) and "HOPE NOW Hails Broad Effort to Refinance and Modify Mortgage Loans," HOPE NOW press release, December 6, 2007, available at www.hopenow.com.



- *Industry not working with borrowers before default*. Only 1 agency reported that the industry as a whole was working with borrowers before default. Individual servicers did not fare much better.

- *Worst performers.* Only 1 agency responded that Merrill Lynch was working with borrowers prior to default. HomEq and HSBC each only received two responses that they were working with borrowers before default.

- *Triage over prevention?* The results for most companies were generally worse in September than was reported for the last survey in April. This may reflect that servicers are becoming increasingly overwhelmed by the number of borrowers falling into foreclosure, and are prioritizing those close to foreclosure over those who are trying to avoid falling behind on their payments.

Counselors Speak:

- "They all say, 'come to us before you get in trouble,' but in the real world, if you're not 3 months behind in your mortgage, they don't have a problem. They are getting their

money and that's all that counts. . . Most times, modifications are for foreclosure victims only."

- "Most clients are told to be 60-120 days late [before] they'll talk to you.Many are told 'not in urgent/dire need of help YET!!!'"

- "Only when a lawsuit is filed against them."

- "It is hard to say that any lender does this consistently. Many borrowers reach customer service/collection departments and these representatives often pursue when and how much of a payment can be made and want to update financials rather than discuss other options. Frequently for customers that are current they won't discuss any options. Many of the borrowers we see remain current by going into further credit card debt to maintain payment, so being current is not a true picture of borrower's ability to make payment."\

E. Servicers are still 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 23 companies were named as servicers that are difficult to work with.

- Wachovia was named most often, with 14 groups listing Wachovia/World as difficult to work with. Next came Wells Fargo and Ocwen, which were named by 9 groups.

F. Counseling agencies are frustrated. When asked to comment on companies that are especially difficult to work with, counseling agencies had a lot to say. Respondents continued to express frustration with companies that do not offer any real solutions and provide poor customer service. Below is a sampling of comments made by counseling agencies. The full text of all comments made can be found in Appendix I.

- "They refuse to consider anything except the start rate; … like pulling teeth if you can get them on the phone ….they keep 'losing' faxes..."

- "Reps are very rude and not helpful."

- "Have no human element, everything is black and white, if the client is outside the box of what their guidelines are they will not even consider."

- “Don’t listen, unorganized, too many loans, overwhelmed workers don’t care.”

- “Does not furnish requested documents after authorization from client to do so has been submitted… does not return messages, difficult to communicate with.”

- “Doesn’t listen, rude & don’t follow on promises, told clients they weren’t in a bad enough situation (they’re $18,000 in debt from borrowing on credit cards to pay them) but they won’t help. All lenders tell clients to borrow, sell stuff,2nd job, etc.”

- “Some of these are merely servicers and use that as an excuse not to modify … puts you on hold for 30-40 minutes before a rep picks up and never seems to come to conclusions on files.”

- “98% of lenders/servicers [are difficult]. Customer service is constantly redirecting and once you get the right department you have to start all over again from faxing the authorization form and wait again for 48 hours to talk to some one at the LM [loss mitigation] dept.”

- “They said to me that, ‘we don’t modify loans.’ Also, most of the servicers seem very hesitant on working out reasonable solutions for our homeowners.”

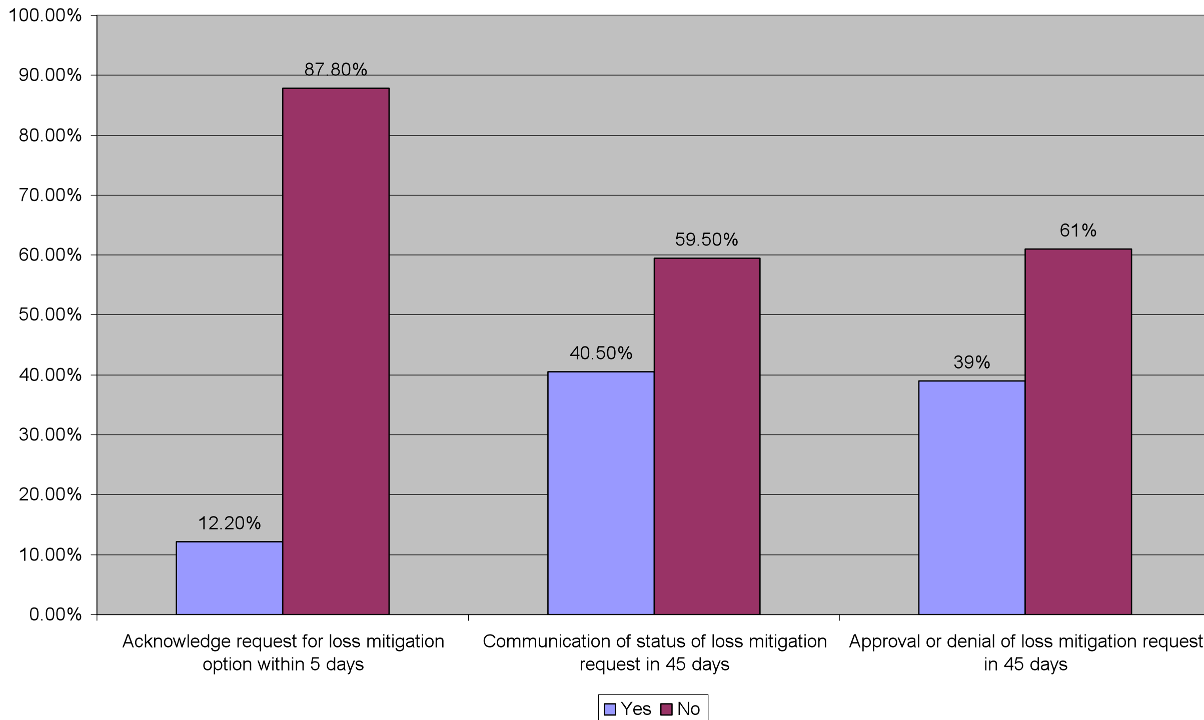
III. Federal and State Initiatives Are Not Working.

A. HOPE NOW Questioned. The most significant federal efforts to prevent foreclosures to date have centered on the HOPE NOW alliance, a Washington, D.C.-based coalition of mortgage servicing companies, industry trade groups and housing counseling agencies. HOPE NOW has put out over 50 press releases touting the success of the industry in helping borrowers avoid foreclosure. For example, on October 27, 2008, HOPE NOW issued a press release announcing that due to its efforts and those of the broader mortgage industry, nearly 2.5 million homeowners have avoided foreclosure and been able to stay in their homes since July 2007, including 212,000 in September alone.[19] It was press releases like this—so at odds with the experiences of borrowers and counseling agencies in California—that inspired these surveys.

CRC is not alone in questioning the accuracy of HOPE NOW statements and data. John C. Dugan, Comptroller of the Currency, has previously noted that "virtually none of the (HOPE NOW) data had been subject to a rigorous process to check for consistency and completeness – they were typically responses to surveys that produced aggregate, unverified results from individual firms. That lack of loan-level data validation raised real questions about the precision of the data, at least for our supervisory purposes."[20] Questions about the HOPE NOW and other data argue strongly for reporting requirements that are subject to regulatory review, validation, and public scrutiny.

On June 9, 2008, in response to concerns that servicers were not responding to borrowers in a timely fashion, HOPE NOW released its Mortgage Servicing Guidelines. The Performance Measures within the Guidelines identified a timeline for when servicers would agree to get back to homeowners to acknowledge receipt of a homeowner's request for loss mitigation assistance, update homeowners on the status of the review process, and communicate approval or denial of loss mitigation requests.[21]

[19] HOPE NOW, "Monthly Foreclosures Prevented By Mortgage Industry Now Almost 2.5 million," October 27, 2008.
[20] "Subprime Loss Mitigation a Battleground for OCC, Hope Now," Inside B&C Lending, June 20, 2008, p. 1.
[21] See http://www.hopenow.com/upload/press_release/files/Mortgage%20Servicing%20Guidelines.pdf.



- *Did you get it?* 87.8% of counselors reported that servicers were NOT acknowledging requests for loss mitigation within the 5 days agreed to by HOPE NOW servicers

- *What happens now?* 59.5% of agencies reported that servicers were NOT communicating about the status of loss mitigation requests within the 45 days agreed to by HOPE NOW servicers. (Actually, the HOPE NOW Guidelines called for servicers to agree to communicate regarding the status of loss mitigation requests within 30 days, but CRC asked agencies about servicer responses within the longer 45-day period.)

- *What do you say?* 61.5% of agencies reported that servicers were NOT approving or denying loss mitigation requests within the 45 days agreed to by HOPE NOW servicers.

Counselors Speak:

- "Ha! LOL! 6-9 months it takes on average to get an affordable modification (38-41% of actual household income) approved or denied."

- "This is the single biggest factor leading to foreclosure among those who want to work with the lender to save their homes. Little or no timely response."

- "Depends on who you know or who you complain to. Always a different person on the phone & you have to explain from scratch."

- "Takes 3-5 days to upload paperwork and 7-14 days for a response. Modification taking average of 90 days."

- "While some responded within 45days, most are taking 60+ days, and few are holding off on foreclosure during the process or halting trustee sales."

- "This has only been with Countrywide through Best Fit."

HOPE NOW has been involved in a number of public initiatives, such as the Paulson "Teaser Freezer" Plan and Project Lifeline. Yet foreclosures continue to increase and counseling agencies continue to report a lack of responsiveness from servicers.

B. DOC data and administration efforts questioned. The California Department of Corporations (DOC) has been collecting loan servicing data from state-licensed servicers, and making aspects of that data available to the public in an aggregated form. Data collected has been fairly detailed. One of the questions DOC asks in its survey regards the amount of time callers must wait to speak to a servicer.[22]Since February 2008, the DOC has consistently reported that state-licensed servicers are keeping borrowers on hold for less than one minute. Counseling agencies report an entirely different experience with loan servicers, both state-licensed and federally-chartered.[23]

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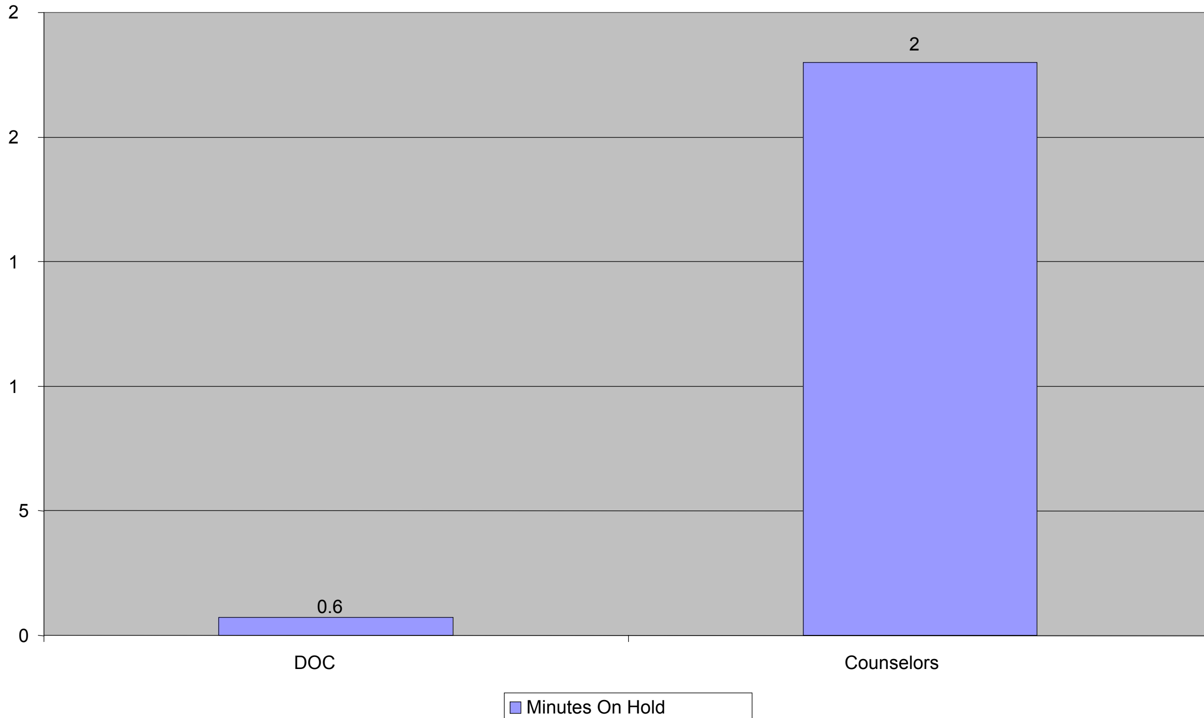
[22] DOC defines the wait time question as follows: "4. Average Collections Calls Wait Time (in seconds): The average time a borrower waits to speak to a servicing associate - The calculation should measure the number of seconds between when borrowers are placed on hold to when a servicing associate takes the call (i.e., this is measured after IVR and with zero second delay)." http://www.corp.ca.gov/press/news/spl/LLMS0808.pdf.

[23] DOC collects data on state-licensed servicers. Counseling agencies responding to this survey are attempting to contact state-licensed and federally-chartered servicers.



- Depends on who you ask. State-licensed servicers report to DOC that callers wait an average of 41 seconds (.68 minutes) to speak to a servicer. Counseling agencies reported an average wait time of 23 minutes.

- 4 groups reported experiencing an average wait time of 1 hour or more. One agency reported an average wait time of 100 minutes.

Additionally, the Governor recently cited DOC's data to demonstrate that his Subprime Loan Agreement was working to stave off foreclosures and increase loan modifications.[24]In reality, the foreclosure crisis is worsening, and there is no concrete evidence that the Agreement is working.

The Agreement requires mortgage servicers to reach out to borrowers before their loans reset, and to freeze interest rates for five years for borrowers who are current on their payments, but won't be able to afford an impending interest rate increase. The Agreement is positive, but helps

[24] "Gov. Schwarzenegger Highlights Subprime Mortgage Agreement's Progress in Preventing Foreclosures" press release, October 29, 2008, http://gov.ca.gov/press-release/10918/.

too few borrowers. The Administration has never reported directly on the success or failure of the Agreement, despite repeated requests.

Relying on DOC servicer data to confirm the success of the Subprime Loan Agreement is dubious because DOC data include several servicers who have not signed the Agreement, and report all types of loan modifications for all types of borrowers, whether they are subject to the Agreement, or not. Efforts to confirm and better understand the Administration's methodology and use of the data have been unsuccessful.

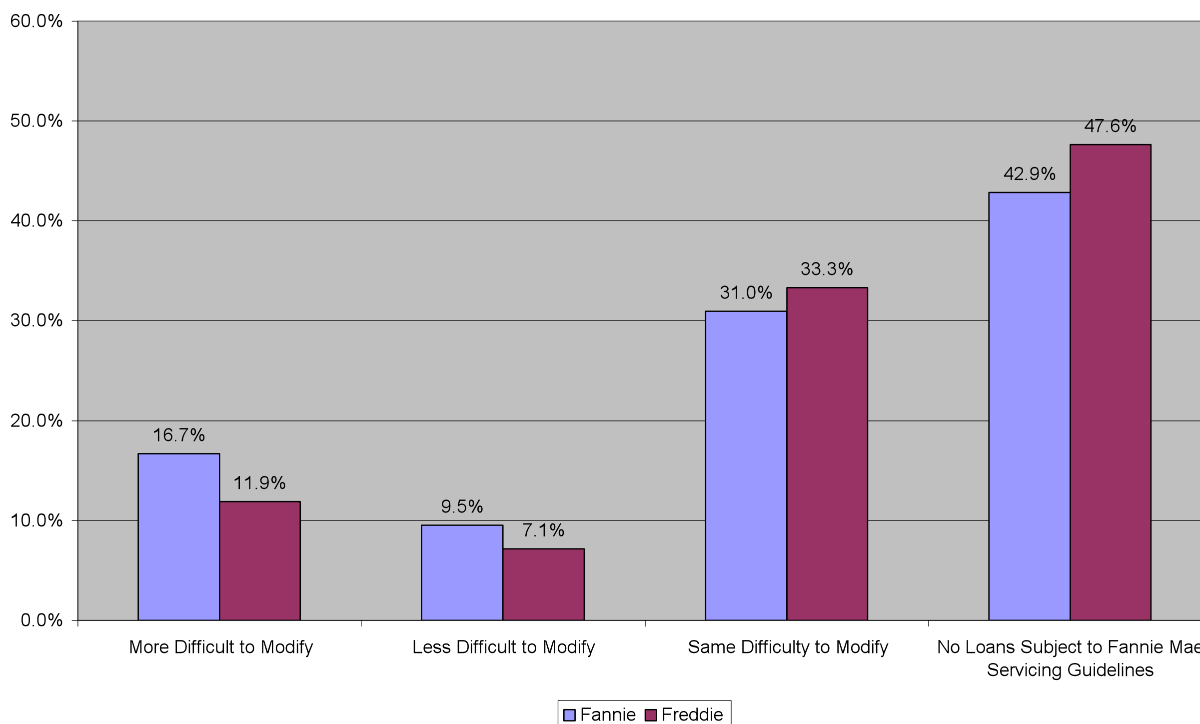
To the Governor's credit, he recently articulated a need for the state to deal with the foreclosure crisis, called the Legislature back for a special session, and put forth a proposal that would give each servicer the choice of implementing an aggressive loan modification program, modeled after that of the FDIC at Indymac Bank, FSB, or be subject to a 90-stay on all foreclosures. While positive, the proposal is limited in a number of respects, especially relating to monitoring and enforcement. The proposal appeared to prohibit public reporting of servicer-specific data to track loan modifications made under the program.[25]

C. Fannie Mae and Freddie Mac: Part of the Problem or the Solution? Fannie Mae and Freddie Mac have long been huge players in the mortgage market, through purchases of conventional loans and investments in a variety of loan products. Counseling agencies have complained that borrowers seeking a loan workout BEFORE falling into default are often told to call back when they are behind in their payments. Anecdotal evidence suggests that Fannie Mae Servicing Guidelines may have frustrated efforts to modify loans before default. An industry publication recently noted that servicers for the Fannie and Freddie continue to favor repayment plans for nonprime loss mitigation, and that loss mitigation on nonprime mortgages serviced on behalf of the GSEs actually decreased in the second quarter of 2008.[26] Additionally, Fannie Mae and Freddie Mac are often cited as amongst the largest investors in loans where the borrowers are seeking loan workouts subject to investor approval. CRC has been concerned that Fannie Mae and Freddie Mac have not done enough to ensure that loans subject to their servicing guidelines, and loans where they are the largest investors, are modified before falling into foreclosure.

Since the U.S. Government purchased a large majority of the shares of Fannie and Freddie and put them into receivership, the ability and imperative to ensure that Fannie and Freddie are aggressive in helping families maintain homeownership has been clear. A recent announcement that Fannie and Freddie will aggressively work to modify some of the delinquent loans it owns or guarantees is, like most initiatives, positive sounding but unlikely to produce the results that are needed. Even FDIC Chair Sheila Bair expressed some concern about the proposal covering too few loans, not clearly ensuring a sustainable loan modification, and not being subject to

[25] For information on the Governor's proposal, see, "Governor Schwarzenegger Prescribes Solutions to Keep Californians in their Homes," press release, November 5, 2008, http://www.gov.ca.gov/press-release/10959/.
[26] "Non prime mods increase, but not for GSEs," Inside B&C Lending, October 31, 2008.

sufficiently detailed reporting to determine compliance.[27] The former GSEs, now under government control, should lead the way in implementing best practices in foreclosure prevention, and not be an obstacle to keeping borrowers in their homes. The recently announced foreclosure moratorium on GSE-owned loans during the holidays[28] is encouraging, and should be expanded upon.



- Counseling agencies responding were slightly more likely to report that both Fannie and Freddie-serviced loans were more difficult, as opposed to less difficult, to modify than loans not subject to Fannie Mae or Freddie Mac Guidelines.

- Larger numbers of counseling agencies reported the difficulty to modify was the same for GSE and non GSE loans, or that they were not seeing GSE loans.

Counselors Speak:

- "They still require the loan be 120+ days late BEFORE modification and only at market

[27] "Skepticism Greets GSE and Servicer Mod Plans," Inside B&C Lending, November 14, 2008.
[28] Fannie Mae, "Lender Letter 04-08: Issuance of a Temporary Halt to Foreclosures and Evictions," November 20, 2008.

rate."

- "We don't even know who the investor is. No one tells us and due to limited capacity, we do not have the research capability to find out."

- "The guidelines they have for what they will modify are strict."

- "We do extensive work with Freddie servicers and have about a 50% success rate on loans that we recommend for modification."

D. A slew of additional federal efforts have failed to adequately address the foreclosure crisis. The Paulson "Teaser Freezer" Plan, Project Lifeline, FHA Secure, and Hope for Homeowners[29] have all failed to live up to expectations. Even the $700 billion bailout recently adopted by Congress has gone from a program that would buy up distressed mortgage assets in order to reduce foreclosures and free up capital for increased lending, to a capital injection into many of the banks that caused this crisis so that they can buy other banks.[30] Congress' approval of the bailout required the Treasury Department to work with servicers and achieve more aggressive loan modification standards. "Now that we are not planning to purchase illiquid mortgage assets, we must find another way to meet that commitment," Treasury Secretary Paulson said.[31]

But in the words of FDIC Chair Sheila Bair, "As we lend and invest hundreds of billions of dollars to help institutions suffering leverage losses from defaulting mortgages, we must also devote some of that money to fixing the front-end problem: too many unaffordable home loans."[32]

E. One cause for optimism – FDIC. Under the leadership of Chair Sheila Bair, the FDIC has

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[29] In its first two weeks, HUD received 42 applications for the new HOPE for Homeowners product, far fewer than the 203 applications received in the first 2 weeks of the FHA Secure program, which housing counselors report is not being used. See "H4H Strict on Income Verification, First Payment," Inside B&C Lending, November 14, 2008. The government expects only 20,000 troubled borrowers to be able to refinance into more affordable loans through H4H. Alan Ziber, "Expectations lowered for new mortgage aid program," Business Week, November 23, 2008. The FHA Secure program announced in August 2007 has helped only about 4,000 delinquent borrowers, according to HUD Secretary Preston. Hope for Homeowners has received just 111 applications from distressed homeowners since it was introduced on October 1, 2008. See, Associated Press, "HUD Secretary Says Programs Are Ineffective," New York Times, November 20, 2008.

[30] Michael J. de la Merced, "Many Line Up for Cash, But Bailout Plan Falters," New York Times, November 14, 2008.

[31] "Subprime, Alt A Mortgage Purchases No Longer a Priority for TARP," Inside B&C Lending, November 14, 2008.

[32] Edmund L. Andrews, "White House Scales Back A Mortgage Relief Plan," New York Times, November 12, 2008.

been promoting more streamlined modifications. Having taken over Indymac Federal Bank, FSB, the FDIC has been implementing a streamlined loan modification program that has informed the predatory lending settlement agreement between the Attorneys General and Bank of America/Countrywide, the recent JPMorgan Chase initiative, and Governor Schwarzenegger's most recent plan. Indymac Federal Bank, FSB performed relatively well in this survey, though there were complaints. All of these FDIC-inspired initiatives must be subject to scrutiny in order to ensure success. FDIC Chair Bair has also been working on another promising proposal to use $50 billion in federal bailout money to pay servicers to modify loans and to guarantee half of any losses if modified loans redefault.[33]

F. Concern that servicers have a financial incentive to foreclose. Servicers have long maintained that a large obstacle to loan modification is that many high-risk loans of the last few years were securitized and are now subject to pooling and servicing agreements which severely limit the ability of the servicer to modify the loan. But the FDIC reportedly has found these contracts are rarely as constricting as investors and servicers have been portraying them. The servicer's job is to maximize the investment, which often means taking steps to avoid foreclosure.[34]

Servicers say it's not in their interest to foreclose, but that may not be the case. Foreclosure is cleaner and often the least troublesome solution for servicers. That is so because 1) in a foreclosure the servicer gets paid; 2) foreclosure avoids the possibility of the servicer being sued for exceeding its authority by modifying loans inconsistent with contractual agreements; and 3) foreclosure can help garner a better rating agency grade since the system rewards those who extract the most cash, which is more safely done through foreclosure.[35]

Another analysis of the role incentives play in loss mitigation notes that "servicers' incentives are not always aligned completely with those of the investors, and they have considerable discretion in interpreting PSA [Pooling and Servicing Agreement] language… some foreclosures still occur where both borrower and investor would benefit if such an outcome were avoided."[36]

Professor Alan White has noted three consequences regarding how and when servicers get paid: 1) servicers do not get paid to modify loans; 2) they don't recover their advances at the time of a modification; and 3) in the case of foreclosure, they don't recover advances they have made for

[33] Id.
[34] Joe Nocera, "What Securitization Problem? The F.D.I.C. Weighs In," The New York Times, November 18, 2008.
[35] O Emre Erguanor, "The Mortgage Debacle and Loan Modifications," Federal Reserve Bank of Cleveland, Fall 2008. The article notes that pooling and servicing agreements do not generally address compensation for costs associated with loan modification. "As a result, the modification cost of $750 to $1,000 per loan is a nonreimbursable expense for the servicer."
[36] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, and Eileen Mauskopf, "The Incentives of Mortgage Servicers: Myths and Realities," Finance and Economic Discussion Series, Division of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington D.C., 2008-46.

costs incurred until the sale is complete. These factors can create an incentive for servicers to rush to complete foreclosures, instead of taking the time and expense of working on a long-term, sustainable loan modification.[37]

As one example, "servicers for loans in private-label MBS generally have not employed "door knocker" firms, like those used to contact borrowers with loans in GSE pools, reportedly because they have not been assured that the costs would be reimbursed by the investors. Such firms report contact rates in excess of 90 percent."[38] How hard a servicer tries to modify a loan appears to be more a function of whether it will get paid for its efforts, as opposed to restrictions imposed by investors. Indeed, for the most part, investors do not seem to be actively monitoring servicer performance. "Servicers admitted that investors have rarely questioned a workout, or asked to see NPV [Net Present Value] spreadsheets, or threatened a lawsuit in the past."[39]

The FDIC's proposal to encourage loan modifications combines risk sharing with financial incentives for servicers to modify loans.[40] But why would servicers need a financial incentive to modify loans if they are doing all they can to work with borrowers, within current legal constraints, as they have argued? If servicers are taken at their word, they should make the same loan modification decisions whether they get paid an additional $1,000 or not. The FDIC proposal is a realistic effort to increase loan modifications, yet one that is an indictment, if unintended, of the servicers' role in perpetuating the foreclosure crisis.

G. Is every loan mod a good loan mod? Data reported by servicers to HOPE NOW or regulatory agencies regarding the number of loan modifications completed are suspect if they are not subject to validation and review. Counseling agencies and legal services offices report that they see "loan modifications" that:

- are repayment plans in disguise,
- require desperate borrowers to waive all of their rights to challenge any illegal behavior on the part of the lender and servicer of the loan in exchange for the chance to save their home, and
- are not in the best interest of the borrower and actually increase mortgage payments.

Little research has been done regarding the quality of the loan workouts being offered to homeowners. A recent analysis of monthly servicer remittance reports from July 2007 through July 2008 for 26 mortgage loan pools supports the experience of counseling agencies and legal service offices that not every loan modification is a good modification. The data show that while

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[37] Alan White, "Paying (but not overpaying) the Servicers," November 17, 2008, at http://pubcit.typepad.com/clpblog/2008/11/paying-but-not.html.

[38] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, and Eileen Mauskopf, "The Incentives of Mortgage Servicers: Myths and Realities," Finance and Economic Discussion Series, Division of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington D.C., 2008-46.

[39] Id. at p. 23.

[40] FDIC Loss Sharing Proposal to Promote Affordable Loan Modifications, http://www.fdic.gov/consumers/loans/loanmod/index.html

the number of loan modifications increased, not only did these modifications rarely reduce principal debt burdens, they also failed to even lower monthly payment obligations in nearly half of the cases.[41] This all begs the question of what was the goal of these loan modifications if not to ease payment and debt burdens of stressed homeowners.

No doubt, some of these onerous workouts are counted by servicers as "loan modifications" for reporting purposes. These onerous workouts are pushing homeowners to re-default, fueling concerns about the number of borrowers who fail to keep up with their "modified" loans. The industry then uses these re-defaults on onerous workouts to falsely argue against stronger efforts to modify loans. Yet long-term loan mods with principal reduction are more likely to succeed.

RECOMMENDATIONS

There has been a flurry of recent activity and a number of initiatives relating to the economic and foreclosure crisis which has gripped the country. And yet, the problem continues to worsen. Credit Suisse estimates that 6.5 million loans will fall into foreclosure over the next five years, with the peak in 2008.[42]

What we have in place is not working. Action is needed now.

In order to keep borrowers in their homes, and to address the concerns of housing counseling agencies and legal service offices, CRC urges lenders, the California Legislature, Governor Schwarzenegger, federal banking regulators, Congress and the Bush and Obama Administrations to take the followingkey steps:

- **Stop foreclosures**. Impose a 180-day moratorium on foreclosures to allow enough time for workouts to occur and to halt spiraling property values. Impose foreclosure filing fees that could alter servicers' calculations as to whether it makes economic sense to foreclose, and also could be used to create a foreclosure prevention fund.

- **Modify loans**. Mandate that all servicers adopt FDIC-like streamlined loan modification programs, but include principal reduction to address the problem of underwater homeowners, target modified mortgage payments at 31% of income, and enhance efforts to streamline modifications for those who are still current on their loans but at imminent risk of default. Far too many California families are underwater and/or are suffering from option ARM loans for anything short of principal write-downs to work. Voluntary commitments are not commitments at all, and have proven to fall short. The Treasury Department should adopt FDIC Chair Bair's proposal to use $50 billion in federal bailout

[41] Alan M. White, "Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports," available at http://ssrn.com/abstract=1259538.
[42] "Foreclosure trends – a sobering reality," Credit Suisse, April 23, 2008, available at http://www.credit-suisse.com/researchandanalytics.

money to pay servicers to modify loans and to guarantee half of any losses if modified loans re-default. Additionally, borrowers should be able to opt-in to a formal mediation process in order to ensure that loan modification negotiations are fair and productive, and housing counselors and legal service lawyers should be allowed to represent borrowers in the mediation.[43]

- **Reform the Bankruptcy Code**. Change the Bankruptcy Code so that judges are permitted to modify loans on owner-occupied housing, as can be done for 2nd lien loans, boat loans, and other less compelling credit products. The Center for Responsible Lending estimates that this change could help 600,000 people avoid foreclosure, which is more than any other initiative to date.

- **Reform Fannie and Freddie**. Require Fannie Mae and Freddie Mac to 1) immediately clarify servicing guidelines to favor loan modifications, including for borrowers who are still current on their loans; 2) immediately ensure that Fannie and Freddie are actively promoting loan modification on all loans and loan pools where they are investors; 3) ensure that Fannie and Freddie do not promote the re-redlining of neighborhoods of color by making credit more costly for those neighborhoods most affected by foreclosure, deemed "declining markets" or considered per se too risky; and 4) develop a plan to ensure that Fannie and Freddie's exit from Low Income Housing Tax Credit Market does not continue to adversely affect the ability of nonprofit groups to develop quality, affordable housing, especially given the increased demand for such housing created by the foreclosure crisis.

- **Create Accountability**. All loan servicers must be required to submit detailed loss mitigation data to regulatory bodies, this data must be subject to validation and review, and the data should be made available to the public. This is the only way to get beyond dueling press releases, to truly inform policymakers and the public as to what is going on, and to encourage better business practices by subjecting those practices to the light of day.[44]Just as the Home Mortgage Disclosure Act has required detailed reporting and analysis of lending performance, a similar requirement would end debates about which press releases to believe, and will shed light on what is currently an opaque industry process.

- **Create transparency**. Require clear certification of ownership of residential mortgage loan debt. This would improve the ability of homeowners to negotiate for loan modifications, and would ensure that all foreclosures are properly carried out only in the

[43] Minnesota is considering a similar approach. H.J. Cummins, "Foreclosure mediation, relief for the 'little guy'," Star Tribune, November 21, 2008, at StarTribune.com.
[44] Citibank voluntarily reports some of this data on its website, throwing into serious question industry arguments that this data are private or contains trade secrets.

name of the true holder of the debt.[45]

- **Reform the lending system**. The abusive and predatory lending practices that placed borrowers into high-risk loans and fueled our current crisis should be outlawed, investors held liable for any such abuse, and borrowers be given a clear ability to vindicate their rights in the courts. Abusive products and practices that should be outlawed include, amongst others:
    - **Steering** borrowers into higher cost loans than borrowers qualify for;
    - **Prepayment penalties** that trap borrowers into bad loans or strip equity;
    - **Yield Spread Premiums** that creative financial incentives for brokers to charge borrowers higher rates; and
    - **English-only documents for non-English speakers,** especially when the loan was negotiated in a non-English language.

- **Modernize CRA**. The Community Reinvestment Act should be expanded to require that all financial firms, including credit unions, insurance companies and investment houses have a clear obligation to reinvest and to make low-cost credit available in communities where they do business.

- **Reform the regulatory system**. Revise our current system of oversight of the financial sector to prevent regulator-shopping and charter-shopping, where financial institutions simply choose another regulator if they don't like the one they have. This only creates a regulatory race to the bottom that encourages agencies to lower standards.

- **End preemption**. Financial institutions should not be able to evade state laws and oversight by obtaining a federal bank charter. States are better able to address local problems, but are frustrated by their limited authority and arguments that state regulation creates an uneven playing field.

[45] This idea has been articulated and advocated for by Maeve Elise Brown of Housing and Economic Rights Advocates, www.heraca.org.

APPENDIX I: COMMENTS OF COUNSELING AGENCIES AND LEGAL SERVICE OFFICES

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:

“Select Portfolio Servicing; they refuse to consider anything except the start rate; Citi Residential - like pulling teeth if you can get them on the phone. Wachovia: won’t consider permanent fixed rate terms; Ocwen & Wamu - they keep ‘losing’ faxes...”

“Indymac, almost impossible to get someone to call back, work with clients.”

“Ocwen. Indymac. Option One. Wells Fargo. Lack of concern, lack of urgency, lack of sense of timing, although they set the time frame. Failure to stop foreclosure long enough to negotiate & process requests.”

“Countrywide is for me the most difficult to work with, they are not organized to offer real solutions to the homeowners, sometimes they are very rude with people.”

“80% of our clients have Countrywide mortgage, yet it is very difficult to work with Countrywide loss mitigation. We asked for a direct contact for our clients, so we can communicate more easily for our clients since 80% of our cases are with Countrywide. Countrywide actually assigned a couple of agents for us to directly contact, but there was no follow up of any kind. Therefore each of the housing counselors are calling in for every single case going through all the wait time.

“Washington Mutual has very strict loan modification guidelines, and very difficult to be approved for loan modification.”

“Wachovia & OCWEN consistently deny working with any clients for any type of loan modification. They say they only approve for ‘repayment plan’ or ‘foreclosure’ - Not even short-sale.”

“U.S.Bank. Reps are very rude and not helpful.”

“GMAC does not provide realistic options for their borrowers. Litton is charging for loan modifications.”

“Wachovia, WaMu and Citi.”

“Option 1, Ocwen, ASC. All have taken months to make a decision. Ocwen give us only short term solutions while Option 1 takes forever as well, but does not help the client’s situation in the long term. Sun Trust Mortgage Inc. had us on hold for 2.5 hours and then a machine came on stating that they were now closed and cut us off. On average 30 minutes to get to the right person, but before that we could be talking to 2 to 3 different depts or reps before we get to the right person. Chase is the best in that we will always speak to one designated person who is responsible for that particular loan.”

“Indymac- guidelines to qualify for modification are strict, Citi Mortgage- they have no clue what they are doing so you bounce from dept to dept. Wachovia-Have no human element everything is black and white if the client is outside the box of what their guidelines are they will not even consider. Ocwen can be difficult depending on how delinquent the client is they will only consider if client can bring in 30% of delinquent payments.”

“Ocwen and WAMU.”

“Chase, HSBC, Chevy Chase, Home Q, Saxon, Wachovia. General lack of Responsiveness.”

“Wachovia, Countrywide, Wells Fargo.”

“Indy Mac - don't listen, unorganized, too many loans, overwhelmed workers don't care. Same

with WAMU."

"Indymac, Wachovia, American Home Servicing, Option One."

"Wachovia - very difficult to get a response/communicate with them; very inflexible on loan workouts. Countrywide - does not furnish requested documents after authorization from client to do so has been submitted. Wells Fargo - Does not return messages, difficult to communicate with."

"Indy Mac doesn't listen, rude & don't follow on promises. Chase states they don't rec. faxes on x & chg items on loan mod docs. America Service, Wells Fargo & Select Portfolio don't care about clients & want money. Litton & Citi Residential told clients they weren't in a bad enough situation (they're $18,000 in debt from borrowing on credit cards to pay them) but they won't help. All lenders tell clients to borrow, sell stuff, 2nd job, etc."

"GMAC, WAMU, World Savings."

"IndyMac, Countrywide is better now, GMAC, WAMU. I have to assume the investor does not want to modify and may not believe there's as much fraud or lack of equity as there is.

"Select Portfolio- Their system regardless if the homeowner uses it or not will take 20% of the homeowners income for emergency expenses usually putting the homeowner in a deficit."

"Don't know."

"Hard to say."

"Litton, Wells Fargo, ASC, Home Eq, GMAC, Citi."

"GMAC, SPS, ASC---some of these are merely servicers and use that as an excuse not to modify. GMAC puts you on hold for 30-40 minutes before a rep picks up and never seems to come to conclusions on files."
"n/a."

"OCWEN Loan Servicing."

"Countrywide, Wachovia, Wilshire and EMC."

"American Home Mortgage Servicing."

"Downey Savings - they only have 25% of their loans that are eligible for mod because 75 % are in investor pools."

“All Citi/ASC/OCWEN/LITTON: Most common response is investor does not allow options; Aurora: Clients have to have 20% surplus.”

“Wachovia.”

“Countrywide: BofA buyout and legal actions.”

“Wachovia.”

“98% of lenders/servicers. Customer service are constantly redirecting and once you get the right department you have to start all over again from faxing the authorization form and wait again for 48 hours to talk to some one at the LM dept.”

“GMAC.”

“Wachovia- They said to me that, "we don't modify loans". Also, most of the servicers seem very hesitant on working out reasonable solutions for our homeowners.”

“Wachovia has only offered repayment plans. A few new plans were outlined by head of San Antonio Loss Mit department, but when called many representatives are not familiar with these options. Wachovia is not offering reduced or stabilization of interest or reducing payments.”

“Popular mortgage.”

“Saxon Mortgage, Aurora Home Loans, GMAC, Home Eq, Ocwen, and most small servicers.”

“Varies from lender to lender and people involved.”

“Americas Servicing Company is the most difficult to work with because of a lack of communication between departments.”

“Wachovia looks for ways to turn down the all modification, as does Greenpoint and Litton.”

APPENDIX II: CRC Response to Federal Policy Efforts

California Reinvestment Coalition

America's National Economic Crisis: *A Few Steps in the Right Direction for Congress*

The Problem:

- An unprecedented national and international economic crisis is devastating communities throughout the country. Low and moderate-income communities are the hardest hit.
- Homeowners lose their homes due to foreclosure, landlords evict tenants despite prompt rent payments, employers lay off workers, and vacant houses drain the social and financial resources of neighborhoods. At the same time, the cost of living is rising: the price of food, gas and other necessities continues to increase dramatically.
- Many small and mid-size businesses are closing due to the economic slowdown and lack of access to bank credit; others face a serious risk of going out of business.
- The federal government responded by passing a huge, $700 billion "bailout package" (the "Emergency Economic Stabilization Act of 2008"), which works for banks and investors with no strings attached, but fails millions of Americans.
- Banks are exploiting this economic disaster by "becoming too big to fail." The Government has handed banks increased funds for acquisitions and consolidation, without regulatory oversight or public scrutiny to protect taxpayers. A next step must be a strong regulatory oversight structure to avoid this crisis occurring again.

A Few Key Steps toward Solutions:

- **Six Month Moratorium on Foreclosures:** The federal government should enact an immediate moratorium on foreclosures. The moratorium should be in effect for at least 180 days to allow borrowers to work with counselors, loan servicers and lenders. The goal must be modification of the loans, to make them affordable through interest rate adjustments and reduction of principal. Currently, servicers are not modifying loans and neighborhoods suffer as foreclosure pushes families from their homes. Home owners should still be responsible for affordable payments during the period.
- **Save Neighborhoods Not Banks**: The government should mandate that the funds invested in banks are used for the responsible extension of credit to small businesses, consumers and home owners. The economy has stalled due to a lack of credit from banks. For small businesses, consumers and homeowners, access to credit is essential for their growth and survival.
- **Keep People in their Homes**: Mortgage companies must modify predatory loans so that people can stay in their homes. Home owners need fixed rate, 30-year loans at affordable terms. The government owns Fannie Mae and Freddie Mac and a sizeable investment in financial institutions as part of the bailout package. This gives it unprecedented authority and opportunity to create these modifications immediately.

- **Give Bankruptcy Judges Authority to Solve Problems**: Many borrowers have been driven into bankruptcy by a variety of predatory loans, including toxic mortgage products. Bankruptcy judges currently have the authority to adjust all loans, except mortgages on owner-occupied properties, to help create an affordable repayment plan for the borrower in trouble. Congress should allow local bankruptcy judges to make the final determination for all of a borrower's assets. Individuals can benefit from the bankruptcy judge's expertise, which will make it possible for a borrower to receive an affordable modification that factors in all of their obligations.