

HAMP: Is Treasury Fighting a Losing Battle?

The mixed results of the Treasury Department's Home Affordable Modification Program (HAMP) leave many homeowners out in the cold – and not only distressed borrowers. Even homeowners who are not threatened by foreclosure are dreading forecasts as they watch their real property values decline. The modest achievements of HAMP have (at best) delayed many foreclosures still to come. Many economists agree that those delays have forestalled a potentially deeper spiral in the residential housing market by stemming the volume of properties appearing on the market during the deepest point in the recession. However, the growing inventory of distressed real estate created by delayed foreclosures casts a long shadow over sunny projections of recovery.

HAMP's Failure: The Elephant in the Room

On April 29, 2010, the U.S. Senate's Subcommittee on Financial Services and General Government, headed by Chairman Richard J. Durbin (D-IL), held a hearing entitled, "Holding Banks Accountable: Are Treasury and Banks Doing Enough to Help Families Save Their Homes?" During his testimony, Treasury Secretary Geithner acknowledged the challenges facing the housing market when he conceded, "There is still a lot of hardship and pain ahead." Geithner also offered a sober reality check: while there are approximately 6 million American homeowners who are 60+ days delinquent on their loans, he explained that HAMP is designed to "reach only a portion of people at risk."

HAMP's target audience of 3 million - 4 million homeowners (to be reached over the next 3 - 4 years) includes the following:

- Victims of predatory lenders;
- Borrowers with traditional mortgages who saw home values fall; and
- Borrowers who fell victim to the broader economic situation, lost their jobs, and are now facing foreclosures.

Meanwhile, HAMP will not provide relief to other categories of homeowners, including:

- Homeowners who have already vacated their homes,
- Borrowers with loans above Fannie Mae/Freddie Mac limits,
- Borrowers with loan payments that they can already meet (at or below 31% of their income),
- Borrowers carrying mortgages for their second homes, and
- Borrowers whose mortgages are the result of speculation.

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“...HAMP risks being remembered not for catalyzing a recovery from our current housing crisis, but rather for bold announcements, modest goals, and meager results.”

Geithner is acutely aware of the shadow inventory of homes likely to enter the residential market and further depress home values. He argued that the Obama administration’s recognition of the threat posed by the economic crisis to household wealth was the impetus for its quick action to protect a “critical component of financial security.” The alacrity of government efforts to stabilize the mortgage system has provided welcomed relief for 1.2 million homeowners who have begun trial modifications through HAMP, saving an average of \$500 per month on their mortgage payments. That accomplishment, however, does not mean that HAMP’s efforts to date are widely recognized as “successful.”

After hearing Geithner’s prepared remarks, Durbin put HAMP’s accomplishments into perspective (and on the record): “HAMP accomplished 230,000 permanent loan modifications during its first year; less than the number of foreclosure notices sent out in March 2010; and less than the number of actual bank repossessions of homes in the first quarter of 2010. There were 2.8 million filings for foreclosures in 2009 and 4 million projected in 2010.”

Problems with HAMP

In a February 2010 newsletter, Arkadi Kuhlmann, CEO of ING Direct USA, asserted that a pri-

mary reason for HAMP’s limited success is that “the government is suffocating banks with counterproductive accounting rules.” Legal restrictions can make write-downs a “huge financial disincentive” to modification offers. For example, if a bank reduces 200,000 borrowers’ monthly mortgage payments by \$400 over a two-year period, it will be required to report a \$1.92 billion loss (i.e. 200,000 loans x \$400 x 24 months) on its books even though it is still scheduled to receive the totality of the loan principal (albeit without the interest). Kuhlmann argues quite persuasively that because banks do not want to express the “loss,” they are reluctant to modify. Kuhlmann’s prescription is to “modify the modification process.”

During the hearing, Chairman Durbin, Richard Neiman (a member of the Congressional Oversight Panel – COP), and Kuhlmann all agreed that the HAMP application process is riddled with problems and “scattered everywhere.” These inefficiencies are making enforcement difficult and allowing banks to “wear down” borrowers with unnecessary delays. Geithner acknowledged the gravity of the situation when he cited countless calls from frustrated borrowers claiming that servicers, among other things, lost or claimed to have lost their application docu-

ments. Neiman called for the creation of a singular application portal, which would be maintained by Treasury in order to process all applications and to ensure program fairness.

Geithner pledged to publish more detailed data on the performance of servicers so that their compliance (or noncompliance) can be scrutinized by Congress and reviewed by homeowners. Geithner appeared determined to address what he believes are insufficient efforts by loan servicers, some of whom have reportedly foreclosed on potentially eligible borrowers, and others who have steered borrowers away from HAMP and into lender-initiated modification programs. Contemporaneously with the pending publication of more in-depth compliance data, Treasury is compelling servicers to re-review groups of mortgages (and in some cases, entire portfolios) for eligibility. In instances where servicer non-compliance is evident, Treasury is withholding incentives or demanding repayment of already issued incentives.

Underwater Homeowners are Drowning

Servicer non-compliance and delays represent only a partial explanation for HAMP’s limited success: The real problem is that many distressed borrowers owe more than the current market value of their homes. These “underwater” homeowners, whose numbers CoreLogic estimates to be nearly one in every four homeowners, represent the greatest challenge to HAMP’s success because negative equity (as reported by the CoreLogic and cited by the COP) “is more highly correlated

with foreclosure than any other factor, besides a lack of affordability.” Paradoxically, principal reductions – while not mandated by HAMP – are the primary way of helping underwater homeowners. The paradox is not easily resolved. Because higher loan balance sizes generate more income for servicers; principal reductions result in decreased servicer compensation. In contrast, interest reductions have no bearing on how servicers are compensated. It should come as no surprise that, according to Treasury’s April 2010 progress report for HAMP, only 84,370 loan modifications (i.e. 28.6% of the 295,000 active permanent modifications) were achieved through principal reductions. While Treasury is currently working on new incentives for principal reductions under HAMP, mandating them still remains politically tenuous.

Principal Reduction: The Political Questions

During the House Committee on Financial Services’ April 13, 2010, hearing, David Lowman, CEO of JPMorgan Chase Home Lending, expressed concern for rewarding irresponsible borrowers with principal reductions:

“There is no provision in the mortgage contract, expressed or implied, that the lender will restore equity or reduce the repayment amount if the value of the collateral...depreciates. ... Additionally, a broad-based second-lien principal reduction plan

would be forgiving past consumption by borrowers rather than housing investment. According to both internal Chase and Federal Reserve data, over 50% of borrowers used home equity loan proceeds for repayment of debt or personal consumption.”



Jeffrey Miron, senior lecturer in economics at Harvard University, expressed the same concern over proposed mortgage bailout plans when he argued: “The plan penalizes cautious taxpayers to bail out those who took bigger risks.” Even Neil Barofsky, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), recognized the dilemma posed by principal reductions: “The voluntary nature of the HAMP principal reduction plan sets up situations where some borrowers benefit, while others who may be just as deserving, do not.” In addition to the experts, many Americans who are feeling the turbulence of the current economy and struggling to remain current on their mortgage payments are unsympa-

thetic to troubled borrowers who “were irresponsible.” Consequently, after all of the hearings, testimony, and pontification, there is little evidence to suggest that Congress (keenly aware of what Geithner referred to as the “moral dilemma” posed by principal reductions) has the appetite to create legislation mandating principal reductions in order to rescue underwater homeowners.

When the costs of principal reductions (industry estimates vary between \$800 billion – \$900 billion) are considered for mortgage investors and future borrowers, the dilemma looks more like a conundrum in which no desirable outcomes are to be had.

Will HAMP Remain a Dream Unfulfilled?

In his testimony before Durbin’s subcommittee, Kevin Puvalowski, Deputy Special Inspector for SIGTARP, summarized HAMP’s mixed results and issued an ominous warning: “Until Treasury fulfills its commitment to provide a thoughtfully designed, consistently administered, and fully transparent program, HAMP risks being remembered not for catalyzing a recovery from our current housing crisis, but rather for bold announcements, modest goals, and meager results.” Principal forgiveness needs to be included to ensure that these programs are to be broadly successful. (See our article dated, 5/11/2010 http://www.paladinsp.com/research_publications.html)