What Mortgage Companies Are Doing Now – A Debtor-Side Perspective

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Introduction

According the Congressional Oversight Committee Panel's October 9, 2009 Report, "one in eight mortgages is currently in foreclosure or default, and the crisis is estimated to produce 10 to 12 million foreclosures."[1] Seeking to protect the economy from the systemic consequences of home foreclosures, the federal government has implemented numerous programs to encourage mortgage companies to modify or refinance certain mortgages (See Appendix A). But what are the mortgage companies really doing now?

A. Yes, They Are Foreclosing

Mortgage companies are proceeding with foreclosure on the majority of delinquent mortgages. From July, 2007 through August, 2009, 1.8 million homes have been lost to foreclosure and each month, 250,000 foreclosures are initiated.[2] With unemployment above 15% in the State of Michigan, cut backs in overtime and hourly pay rates of the employed, and rising mortgage payments (usually as a result of ARM changes), mortgagors are unable to keep up on their mortgage payments. Exacerbating the problem are falling housing prices, making many mortgagors conclude that the monumental effort that it will take to meet their mortgage obligation under the strain of severely diminished income is just not worth it. As a result, the mortgage companies are initiating foreclosures. During the second quarter of this year, foreclosures in process rose to 992,554 (2.9% of all serviced loans) and increased 15.3 percent from the first quarter, an increase of 79.4 percent from a year ago.[3] Many of these foreclosures are initiated despite mortgagors' efforts to negotiate a loan modification or refinance.

[1] October 9, 2009 Oversight Report, An Assessment of Foreclosure Mitigation After Six Months, at http://cop.senate.gov/documents/cop-100909-report.pdf.
[2] Oversight Report at page 3.
[3] Office of Comptroller of the Currency and Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report, Second Quarter of 2009, at www.occ.gov/ftp/release/2009-118a.pdf.

B. Modifications – Not Enough

In March, 2009, the Department of Treasury introduced the Making Home Affordable initiative (MHA) to combat foreclosures, which includes a program to encourage refinancing, the Home Affordable Refinance Program (HARP) and the Home Affordable Modification Program (HAMP). As of September 1, 2009, the Home Affordable Modification Program has facilitated only 1,711 permanent loan modifications.[4] Although the program is only six months old and requires that the mortgagors enter a three-month trial modification before qualifying for a permanent modification, the number is still dismally low. Only 352,348 borrowers are in the 3-month trial program[5], a small number compared to the overall foreclosure-commencement rate of 250,000 per month.

On possible reason that some have cited for the slow pace of modifications is that the securitization pooling and servicing agreements (PSAs) of many mortgages create a contractual limitation on what the mortgage loan servicers can offer in a loan modification.[6] Indeed, the federal programs do not attempt to change these contractual requirements. This limitation makes the offered modification unattractive to mortgagors and may cause some of them to decline the modification offer and let the house go into foreclosure. This theory does not, however, account for the low number of modifications because "portfolio loans", loans owned by the servicing companies themselves, are not being modified at a higher rate that those mortgage loans subject to PSAs.[7]

[4] Oversight Report at page 3.
[5] Oversight Report at page 3.
[6] Testimony of Adam Levitin, "Three ABI Members Testify During Busy Month for Congressional Hearings, American Bankruptcy Institute Journal, September, 2009.
[7] Manuel Adelino, "Why Don't Lenders Renegotiate More Home Mortgages? Redefaults,, Self-cures, and Securitization," Fed. Reserve Bank of Boston, Public Policy Discussion Paper, No. 09-4, July 6 209 at www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

Another possible reason is that loan modifications are just not profitable.[8] The "mortgage companies" are mortgage loan servicers who are encouraged by the federal programs to offer modification by financial incentives. Under the Home Affordable Modification Program (HAMP), the mortgage loan servicer will receive $1,000.00 per modification. But modifications require individual accounting work which is not compensated.[9] "The rules by which servicers are reimbursed for expenses may provide a perverse incentive to foreclose rather than modify". [10] Mortgage loan servicers are paid 0.5% of interest payments plus late fees and other servicing fees in sub-prime mortgages.[11] Mortgage loan servicers may well be compensated more for foreclosing than for modifying the loan, creating a disincentive to modification. The result is that mortgage companies are not going to reduce their compensation in a modification significantly enough to reduce the foreclosure rates. Indeed, foreclosures are outpacing even the trial modifications under the HAMP program.[12]

C. Permanent Modifications Are Not Making Significant Changes

In the second quarter of 2009, 78.2% of mortgage loan modifications lowered the principal and interest payments, 17.4% increased monthly payments, and 4.3% left payments unchanged.[13] Only 10% of modifications actually lowered the principal balance.[14] The majority of modifications combine capitalization of missed payments and fees with an interest rate reduction.[15] The result is little change in the monthly payment requirements and continued or

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[8] Testimony of Adam Levitin, "Three ABI Members Testify During Busy Month for Congressional Hearing, American Bankruptcy Institute Journal, September, 2009, Volume XXVIII, No. 7.
[9] Oversight Report at 122.
[10] Manuel Adelino, "Why Don't Lenders Renegotiate More Home Mortgages? Redefaults,, Self-cures, and Securitization," Fed. Reserve Bank of Boston, Public Policy Discussion Paper, No. 09-4, July 6 209 at www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.
[11] Oversight Report at 122.
[12] Oversight Report at 95.
[13] OCC and OTC Report at page 6.
[14] OCC and OTC Report at page 6.
[15] OCC and OTC Report at page 23.

worsened negative equity. With approximately one third of all borrowers having negative equity in their homes,[16] a significant number of mortgagors are left without a viable modification option. "Negative equity has a higher correlation with default than any other factor that has been identified"[17]

This problem is exacerbated in Michigan, which carries the second highest percentage of homes with negative equity at 40%, trailing behind only Nevada.[18] On July 5, 2009 Michigan implemented MCL 600.3205a, 3205b, and 3205c. The statute changed the foreclosure procedure such that mortgage companies seeking to foreclose are required to negotiate with the mortgagors who request a modification to attempt modify their mortgage loans to reduce the total mortgage payment to 38% of income by reducing interest as low as 3%, extending the term to as long as 40 years, waiving late fees, and deferring principal. The statute does not require the reduction of principal. If an eligible mortgagor is not offered a modification, the mortgage company may not proceed with foreclosure by publication, but must use the judicial foreclosure process. Once a request is made for a modification, the mortgage company must wait 90 days before proceeding with foreclosure. Since the 90 day period has just recently passed since the statute's implementation, it is yet to be determined how many mortgagors make the required request, how many of those actually enter into a modification, and if mortgage companies offer significant concessions.

While concessionary modifications are an effective way of preventing foreclosures,[19] under HAMP, mortgage companies are offering few concessions. The lack of significant savings

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[16] Oversight Report at page 23 citing First American CoreLogic, *Summary of Second Quarter 2009 Negative Equity Data* (Aug. 13, 2009) (online at www.loanperformance.com/infocenter/library/FACL%20Negative%20Equity_final_081309.pdf) (hereinafter "CoreLogic Negative Equity Data").

[17] Oversight Report at 99 citing Stan Liebowitz, *New Evidence on the Foreclosure Crisis*, Wall Street Journal (July 3, 2009) online at online.wsj.com/article/SB124657539489189043.html).

[18] Oversight Report at page 15.

[19] Manuel Adelino Discussion Paper at 2.

for the mortgagors may also provide insufficient relief to those mortgagors who agree to a loan modification that merely capitalizes missed payments and fees and lowers interest (resulting in little or no decrease in payments). Soon thereafter these borrowers find that cannot keep up with the new payments. Indeed, the re-default rate for modifications that reduce the monthly payment obligation by 20% or more are significantly lower at 34.1% after one year compared with modifications that left payments unchanged or increased which are above 63%.[20]

D. It's the System, or Lack Thereof (This is Just Anecdotal)

An unexplored explanation for the lack of modification is that the internal structure and organization of mortgage companies that make the process slow and ineffective. I hear stories every day from new clients who tell me that they tried to work with the mortgage company and got nowhere. Their income was too low. Others are told their unemployment compensation wasn't permanent income that could be "counted". Some are told that their income was too high to qualify for the government program. Further, many mortgage companies will only accept documents by fax but after faxing documents, my clients often report that they then called back the mortgage company to check on the progress of their application only to be told by the mortgage representative said they never received them. One client of mine, after faxing 160 pages three times (and paying per page for those faxes) decided to send them by Federal Express. When he followed up with the representative at the mortgage company the next day, he was told "don't ever do that again!" and heard how overwhelmed that particular representative was with sheer number of modification requests. While it is certainly true that the mortgage companies don't have to "work with" the defaulting mortgagors, many mortgagors are left with the sense that they are just being strung along.

[20] OCC and OTC Report Report at page 34.

Further, the structure of the mortgage companies is such that each "program" is often in a separate department, one for HAMP (the Home Affordable Modification Program), one for HOPE (the Hope for Homeowners program), another for their traditional loss mitigation department, etc. It isn't clear how the calls from homeowners are being filtered to each of these departments. It certainly provides a plausible explanation as to why, for example, one homeowner receives a modification when they become unemployed while another is told that their unemployment compensation does not count as income toward qualification.

After multiple calls, letters, and faxes to the mortgage companies, it becomes apparent that the mortgage companies' representatives in these departments have little authority, and are unable to truly "negotiate" with the homeowners or their attorneys. They follow their department rules and try to reach their performance guidelines in order to keep their job and receive their paycheck. After a frustrating conversation with one of these representatives over the mortgage company's "Authorization" form that she insisted that I sign in order to commence the loan modification process for my client, I was told that I could cross out any parts that I didn't like, add any language that I like, but that she needed that document in the file in order to pass it on for processing.

D. In Chapter 13, It's Even Worse

This is where the frustration begins in the modification process for Chapter 13 Debtors. If the Debtors call the mortgage company to request a modification, they are told that their attorney has to contact the mortgage company. Often when an attorney contacts them, the mortgage representative informs them that since they are not the mortgagor, they cannot speak to the attorney regarding the mortgage account. So, I will send them an authorization signed by the Debtor allowing the mortgage company to release information to the attorney along with a letter requesting a loan modification. I then receive, in many cases, a form Authorization drafted by the mortgage company requiring that the attorney allow the mortgage company to speak to the Debtors directly for the "limited purpose" of discussing a loan modification. Some of these forms even require that the attorney agree to either dismiss the bankruptcy case or lift the automatic stay upon signing of the loan modification. A few mortgage companies such as Ocwen, have created user-friendly forms to attempt expedite the loan modification process that includes a Hardship letter that merely requires the homeowner to check the appropriate boxes and has a checklist of documents to return.

While I do not want my client having direct contact with their mortgage company, especially regarding the information that is normally required such as paystubs, tax returns, bank statements and a signed financial statement, I have seldom been able to get a mortgage company to respond to a loan modification request with without returning one of these forms. Therefore, when necessary, I modify the form to limit the contact and send it to my Clients for signature with an advisory letter that explains the limitation of the mortgage company's contact with them, that they must obtain legal advice before providing any information or agreeing to anything, and that they should not send anything directly to the mortgage company, although they may receive information from the mortgage company.

In my experience, the Debtors who are the most annoyingly persistent at contacting the mortgage company are the most successful at obtaining a modification offer. But even the most persistent fall prey to the structurally inefficient, compartmentalized, or, at best, disorganized mortgage companies. Just recently, one annoyingly persistent client of mine contacted me after his mortgage company told him that, after three months of annoying persistence, his loan modification was ready but that they could not send it to him until he obtained a court order from the bankruptcy a court. My phone call to the mortgage company to request a copy of the loan modification, or at least a statement of its terms, resulted in transfers from the loss mitigation department to the bankruptcy department, and back again until I was ultimately disconnected.

The final problem is that the mortgage companies' procedures do not mesh with the Chapter 13 bankruptcy procedures and requirements. Additionally, many loan modification offers require, according to the written terms of the modification offer, that they be signed and returned in a relatively short period of time, usually less than 30 days. In most instances, this is difficult to accomplish in Chapter 13 Bankruptcy. By the time the document is reviewed by an attorney, the Debtors meet with their attorney to receive advice regarding the benefits and disadvantages of the loan modification, the file is reviewed for feasibility of the Plan and impact of the modification, and a Motion and/or Plan Modification is prepared and filed, it often requires an expedited hearing to obtain court approval by the stated deadline. The result is a limited number of modifications for those in Chapter 13 bankruptcy plans.

F. Short Sales – Not So Much

Nationally, a July, 2009 study found that 14 percent of all home purchases stemmed from "short sales." [21] According to a local real estate agent, due to the falling value of homes, many of the Purchase Agreements signed by buyers and sellers in this area are contingent upon some concessions being made by the mortgagee(s). But, only about one in ten of these deals will close. Most mortgage companies will not reduce the payoff they will accept sufficient to meet the offered price on the property. Additionally, it will take 6-9 months to obtain approval from the mortgage companies. This delay in itself causes many buyers to move on before approval

[21] Campbell Surveys, *Real Estate Agents Report on Home Purchases and Mortgages – 2009,* at www.campbellsurveys.com/AgentSummaryReports/AgentSurveyReportSummary-June2009.pdf

can be obtained. During the second quarter of 2009, only 23,102 short sales were reported nationwide.[22]

Generally, there is little incentive for Debtors who are filing bankruptcy to attempt to sell their home on a short sale. For all of their efforts in readying the house for sale, making it available for showing, negotiating conditions such as repairs, and taking a day off from work to attend a closing, they will receive no payment or other significant benefit.

G. Deed in Lieu of Foreclosure - Hardly

At least one mortgage company, Bank of America, will not consider a deed in lieu of foreclosure until the house has been on the market for at least three months. When trying to avoid a bankruptcy filing for Debtors who owned 5 properties with approximately $800,000.00 in mortgages with Bank of America, I sent signed authorizations for each loan with a request to give a deed in lieu of foreclosure. The response was that it was their policy to require the homeowner to put the property on the market for 3 months before considering a deed in lieu. After filing the bankruptcy, I receive a letter that gave a phone number to call in the future before filing bankruptcy so that we could consider other loss mitigation options in the future with all of my clients. So I called the number and after 6 minutes on hold, an automated system put me through to an unidentifiable voicemail. In many cases, it is a futile effort. Real estate agents are reluctant to list such properties and expend marketing dollars when a sale is unlikely given the large negative-equity position of most of the homes in the marketplace and the limited success at obtaining concessions from the mortgage company. Consistent with this observation, the OCC and OTC Report identifies only 1,032 new deed-in-lieu of foreclosures actions in the second quarter of 2009.

[22] OCC and OTS Report at page 36.

H. Just Writing It Off – Not Foreclosing

In limited areas, mortgage companies are declining to foreclose on certain properties and are writing off the debt instead. Although this is rare, it is important to advise Debtors and potential Debtors that they may not be able to just walk away from their home and have no responsibility whatsoever. Some Debtors find that despite "surrendering" the house and moving out, they are ticketed by the municipality for failing to meet local codes regarding maintenance, such as grass trimming. It is also in their best interest to maintain homeowners insurance until the foreclosure process is completed in case someone claims they have been injured on the property. When the mortgage company declines to exercise its rights under the mortgage, the Debtor will have to wait until the county real estate tax forfeiture process is completed before they are no longer liable as an owner of the property.

I. A Bit of An Aside - Junior Mortgage Holders and Lien Stripping in Chapter 13

The recent decrease in real estate values has created a greater opportunity in Chapter 13 cases to "strip" junior mortgages. The only data that I have regarding the response of the junior mortgage holders comes from my personal experience with cases filed in my office. The adversary proceedings that we file seeking to strip a mortgage lien include an appraisal, proof of the recording of the senior mortgages, and documentation of the balances owed on the senior mortgages. It is my experience that the majority of these mortgage companies do not respond to the Complaint, allowing a Default Judgment to be entered. The few that do respond merely want to have some say in the Judgment language and a Consent Judgment is negotiated. It appears that these mortgage companies are making a sound business decision to not incur litigation costs with little chance of success. It may even be true that their position is better in this context than if the senior mortgage holder forecloses, the junior mortgage lien is extinguished, and no further payments are received. Many of these Chapter 13 Plans also provide for curing the default on the first mortgage, allowing the second mortgage company to receive some payment. Finally, given that the Debtors must complete their Chapter 13 case and receive a discharge in order to obtain a release of the lien, these mortgage companies have a substantial chance of retaining their liens as a result the case being dismissed.

J. New Mortgages and Refinancing- Limited

Mortgage companies have tightened their lending qualification requirements, resulting in fewer new mortgages being written. According to a local mortgage broker at Quicken Loans, Inc., borrowers will only qualify for a mortgage with 5% down if their credit score is over 680. For those with lower credit scores in the mid-600s, a 20% down payment is required to qualify. Even on a modestly prices home, few people have $20,000 to $30,000 cash to put down on a new home.

The falling housing prices are also an impediment to new mortgages being written. In the local market, according to a local mortgage broker, 40-50% of mortgage applications fail due to the appraisal being lower than the purchase price. In the past, a foreclosed home sold was not given as much weight in an appraisal, or left off entirely. Now, the number of bank-owned property sales has increased so much that they are now being included in appraisals, that is, they have become common enough that they can no longer be considered an aberration in the market. As noted in the October 9, 2009 Congressional Oversight Report, this is creating a negative feedback loop that is not likely to end in the near future.[23]

The federal programs designed to encourage mortgage companies to refinance loans have had little success. In October, 2008, as part to the Emergency Economic Stabilization Act (EESA), the HOPE for Homeowners Act of 2008 was implemented. Although this was designed

[23] Oversight Report at page 13.

to preserve homeownership and protect home values,[24] it has been a dismal failure. As of September 23, 2009, a pathetic 94 mortgages have been refinanced through HOPE.[25]

The Home Affordable Refinance Program (HARP) allows mortgagors who are current on their mortgages to refinance up to 125% of the value of their homes. According to a local broker at Quicken Loans, Inc., this has accounted for a limited amount of refinancing to those with good credit and only one mortgage. Although it seems to have created a market for new refinancing where there would otherwise be none, the requirements of being current in payments, good credit, and no cash out to pay off second mortgages makes the number of mortgagors meeting these requirements very limited. Nationwide, 95,729 mortgages have been refinanced under HARP as of September 1, 2009.[26] The majority of these new mortgages are loans with less than 90% loan-to-value.[27] Due to its limitations, HARP offers no relief to those who fall behind on payments, have second mortgages, or have significant negative equity.

Conclusion

What the mortgage companies are doing in response to the mortgage crisis is less important than what should be done to stabilize the housing market. As discussed above, there are not enough modifications taking place to significantly slow the foreclosure rate, and the worsening negative equity in the housing market is a significant impediment to stabilization. The October 9, 2009 Congressional Oversight Panel outlines several options for addressing negative equity for the purpose of the larger public policy goal of economic recovery. While it does not advocate one method over another, it does acknowledge that allowing principal reductions in

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[24] Oversight Report at 26.
[25] Oversight Report at 83.
[26] Oversight Report at 93.
[27] Oversight Report at 42.

Chapter 13 bankruptcy will address negative equity while imposing "costs" on borrowers.[28] The Oversight Report merely states that bankruptcy is not an "appealing" choice to borrowers. However, three to five years of court supervision of one's finances is a significant "cost" for the borrower. When viewed in comparison the other options or the current failing programs, it may well be the one course of action that will keep more mortgagors in their homes.

According the Congressional Oversight Report, until the housing market is stabilized, the economy as a whole will not recover. "Not only is the housing market a major component of the overall economy, but it has been at the center of the economic crisis, and until it is stabilized, the economy as a whole will remain in turmoil".[29] While foreclosures continue in record numbers, housing prices are going to continue to decline. Mortgage loan servicers are really the "Mortgage companies" that are making the decisions about the existing mortgages. These servicers are merely acting under the PSA contracts and exercising their own business judgment as to what is most profitable for their company. Under this circumstance, one cannot expect mortgage companies to solve the problem. In fact, their actions so far have proven to feed the "negative feedback loop or death spiral"[30] in the housing market, with job loss and diminished income leading to defaults, leading to foreclosures that bring down the value of nearby homes, resulting in negative equity which leads to more defaults, which again leads to further foreclosures (see Section A above, **Yes They Are Foreclosing**).

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[28] Oversight Report at 103.
[29] Oversight Report at page 91.
[30] Testimony of Adam Levitin at 68.

Figure 12: Federal Foreclosure Mitigation Programs

Program	When Program Was Announced/Launched	Brief Description	Funding Designated	Goal Number of Homeowners to Assist	Number of Homeowners Helped to Date
Home Affordable Refinancing Program (HARP)	Announced: February 18, 2009 Launched: March 4, 2009	Allows current homeowners to refinance into a more stable or affordable mortgage.	No TARP funds	4 to 5 million eligible	101,201 approved applications
Home Affordable Modification Program (HAMP)	Announced: February 18, 2009 Launched: March 4, 2009	Provides modifications for borrowers in default or imminent default.	$75 billion total. ($50 billion of TARP funds for modifying private-label mortgages and $25 billion from HERA for modifying GSE mortgages.)	Up to 3 to 4 million	417,325 trials and 1,711 permanent
First Lien Modification	*Announced: February 18, 2009* *Launched: March 4, 2009*	*Provides incentives to servicers, lenders, and borrowers to modify mortgages to 31 percent DTI*	*$75 billion total. ($50 billion of TARP funds for modifying private-label mortgages and $25 billion from HERA for modifying GSE mortgages.)*	*Up to 3 to 4 million*	*417,325 trials and 1,711 permanent*
Second Lien Modification	*Announced: April 28, 2009* *Not yet launched*	*Provides incentives to modify or extinguish second liens.*	*Not yet launched*	*Up to 1 to 1.5 million*	*Not yet launched*
Home Price Decline Protection (HPDP)	*Announced: May 14, 2009* *Launched: September 1, 2009*	*Provides loss sharing for "incremental collateral losses" on unsuccessful modifications in falling home price areas.*	*Up to $10 billion of TARP funds*	*Not Specified*	*Data not yet available*

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APPENDIX A

A Summary of Federal Foreclosure Mitigation Progarams
from the October 9, 2009 Congressional Oversight Report

Program	When Program Was Announced/Launched	Brief Description	Funding Designated	Goal Number of Homeowners to Assist	Number of Homeowners Helped to Date
Foreclosure Alternatives Program (FAP)	*Announced: May 14, 2009* *Not yet launched*	*Provides servicers with incentives to pursue alternatives to foreclosures, such as short sales or the taking of deeds-in-lieu of foreclosure.*	*Not yet launched*	*Not Specified*	*Not yet launched*
HOPE for Homeowners	Announced and Launched: October 1, 2008	Allows eligible borrowers to refinance into FHA-insured loans and requires principal reductions	Incentive payments to be funded from HAMP allocation in unspecified amounts	400,000	94 refinancings
FDIC Loan Modification Program	Announced and Launched: August 20, 2008 (for IndyMac) Expanded: November 20, 2008	Established as a mandatory component of all FDIC residential mortgage loss-sharing agreements with purchasers of failed banks' assets	No funds allocated specifically for loan modification; loss-sharing agreements are based on what will result in the least cost to the Deposit Insurance Fund	Not Specified	Data not available