CONGRESSIONAL OVERSIGHT PANEL

OCTOBER OVERSIGHT REPORT *

AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS

OCTOBER 9, 2009.—Ordered to be printed

* Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343

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CONGRESSIONAL OVERSIGHT PANEL

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EXECUTIVE SUMMARY *

From July 2007 through August 2009, 1.8 million homes were lost to foreclosure and 5.2 million more foreclosures were started. One in eight mortgages is currently in foreclosure or default. Each month, an additional 250,000 foreclosures are initiated, resulting in direct investor losses that average more than $120,000. These investors include the American people. The combination of federal efforts to combat the financial crisis coupled with mortgage assistance programs makes the taxpayer the ultimate guarantor of a large portion of home mortgages.

Each foreclosure further imposes direct costs on displaced owners and tenants, and indirect costs on cities and towns, and neighboring homeowners whose property values are driven down. High unemployment and depressed residential real estate values feed a foreclosure crisis that could pose an enormous obstacle to recovery.

The Panel is specifically charged with conducting oversight of foreclosure mitigation efforts under the Emergency Economic Stabilization Act (EESA). In particular, the statute directs the Panel to assess the effectiveness of the programs from the standpoint of minimizing long-term costs and maximizing benefits for taxpayers. To that end, the Panel asked Professor Alan White of Valparaiso University to conduct a cost-benefit analysis. Although federal foreclosure mitigation programs are still getting off the ground, the benefits of foreclosure modification are likely to outweigh the cost to taxpayers.

Since the Panel's March report on the foreclosure crisis, Treasury has unveiled its Making Home Affordable (MHA) initiative, the federal government's central tool to combat foreclosures. MHA consists of two primary programs. The Home Affordable Refinance Program (HARP) helps homeowners who are current on their mortgage pay-

* The Panel adopted this report with a 3–2 vote on October 8, 2009. Rep. Jeb Hensarling and Paul Atkins voted against the report. Additional views are available in Section Two of this report.

ments but owe more than their homes are worth, refinance into more stable, affordable loans. The larger Home Affordable Modification Program (HAMP) reduces monthly mortgage payments in order to help borrowers facing foreclosure keep their homes. As of September 1, 2009, HAMP facilitated 1,711 permanent mortgage modifications, with another 362,348 additional borrowers in a three-month trial stage. HARP has closed 95,729 refinancings, hopefully reducing the number of homeowners who may face foreclosure in the future.

Treasury currently estimates it will spend $42.5 billion of the $50 billion in Troubled Asset Relief Program (TARP) funding for HAMP, which will support about 2 to 2.6 million modifications. If HAMP is successful in reducing investor losses, those savings should translate to improved recovery on other taxpayer investments. But if foreclosure starts continue their push toward 10 to 12 million, as currently estimated, the remaining losses will be massive.

The Panel has three concerns with the current approach.

First is the problem of scope. Treasury hopes to prevent as many as 3 to 4 million of these foreclosures through HAMP, but there is reason to doubt whether the program will be able to achieve this goal. The program is limited to certain mortgage configurations. Many of the coming foreclosures are likely to be payment option adjustable rate mortgage (ARM) and interest-only loan resets, many of which will exceed the HAMP eligibility limits. HAMP was not designed to address foreclosures caused by unemployment, which now appears to be a central cause of nonpayment, further limiting the scope of the program. The foreclosure crisis has moved beyond subprime mortgages and into the prime mortgage market. It increasingly appears that HAMP is targeted at the housing crisis as it existed six months ago, rather than as it exists right now.

The second problem is scale. The Panel recognizes that HAMP requires a significant infrastructure—both at Treasury and within participating mortgage servicers—that cannot be created overnight. Foreclosures continue every day as Treasury ramps up the program, with foreclosure starts outpacing new HAMP trial modifications at a rate of more than 2 to 1. Some homeowners who would have qualified for modifications lost their homes before the program could reach them. Treasury's near-term target for HAMP—500,000 trial modifications by November 1, 2009—appears to be more attainable, but even if it is achieved, this may not be large enough to slow down the foreclosure crisis and its attendant impact on the economy. Once the program is fully operational, Treasury officials have stated that the goal is to modify 25,000 to 30,000 loans per week. Treasury's own projections would mean that, in the best case, fewer than half of the predicted foreclosures would be avoided.

The third problem is permanence. It is unclear whether the modifications actually put homeowners into long-term stable situations. Though still early in the HAMP program, only a very small proportion of trial modifications that were begun three or more months ago have converted into longer term modifications. In addition, HAMP modifications are often not permanent; for many homeowners, payments will rise after five years, which means that affordability can decline over time. Moreover, HAMP modifications increase negative equity for many borrowers, which appears to be associated with increased rates of redefault. The result for many homeowners could be that foreclosure is delayed, not avoided.

Whether current Treasury programs adequately address foreclosures also depends on the future condition of the housing market. Today, one-third of mortgages are underwater, and if housing prices continue to drop, some experts estimate that one-half of all mortgages will exceed the value of the homes they secure. Negative equity increases the likelihood that when these homeowners encounter other financial problems or when life events cause them to move, they may walk away from their homes and their over-sized mortgages. Others may be discouraged about paying off mortgages that greatly exceed the value of the property or give up their homes when they recognize that they would be ahead financially if they rented for a few years before buying again. If left unresolved, redefaults and future defaults related to negative equity could mean that the country experiences high foreclosure rates and housing market instability for years to come.

While Treasury must consider programmatic changes to meet these challenges, so too must it adapt and improve the existing programs in several key ways.

Given the issues facing MHA, Treasury must be fully transparent about the effectiveness of its programs, as well as the manner in which they operate. Although Treasury's data collection has improved significantly since the Panel's March report, it should be expanded, and the information should be made public. Treasury should release its Net Present Value (NPV) model, which is used to determine a homeowner's eligibility for HAMP. The new denial codes should be implemented to provide borrowers with a specific reason for denying a modification and a clear path for appeal. Denial information should also be aggregated and reported to the public.

Treasury should also make the loan modification process more uniform so that borrowers, servicers, and advocates can more easily navigate the system. Uniform documents and more uniform processes would benefit both lenders and borrowers, and would make the program easier to administer and oversee. Treasury should continue its efforts to streamline the system, including through development of a web portal as suggested in the Panel's March report.

The model for determining borrowers' eligibility for the programs could be adapted to accommodate borrowers with arrearages and by incorporating more localized information when determining a mortgage loan's value.

In MHA, as in all of Treasury's programs, accountability is paramount. Servicers who fail to comply with the program's requirements should face strong consequences. Treasury must ensure that Freddie Mac, recently selected to oversee program compliance, has in place the proper processes to provide robust oversight. To further reinforce accountability, Treasury should continue to develop performance metrics and publicly report the results by lender or servicer.

Rising unemployment, generally flat or even falling home prices, and impending mortgage rate resets threaten to cast millions more out of their homes, with devastating effects on families, local communities, and the broader economy. Ultimately, the American taxpayer will be forced to stand behind many of these mortgages. The Panel urges Treasury to reconsider the scope, scalability and permanence of the programs designed to minimize the economic impact of foreclosures and consider whether new programs or program enhancements could be adopted.

SECTION ONE: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS

A. Introduction: What Has Changed Since the Last Report

The United States is now in the third year of a foreclosure crisis unprecedented since the Great Depression, with no end in sight. Of the 75.6 million owner-occupied residential housing units in the United States, approximately 68 percent (51.6 million) of homeowners carry a mortgage to finance the purchase of their homes.[1] Since 2007, 5.4 million of these homes have entered foreclosure, and 1.9 million have been sold in foreclosure.[2] Absent a significant upturn in the broader economy and the housing market, another 3.5 million homes could enter foreclosure by the end of 2010.[3]

Foreclosure rates are now nearly quadruple historic averages (see Figures 1 and 2). At the close of second quarter 2009, the Mortgage Bankers Association reported that 4.3 percent of mortgages, 15.05 percent of sub-prime loans, and 24.40 percent of subprime adjustable rate mortgages (ARMs) were currently in foreclosure. In addition, 9.24 percent of all residential mortgages were delinquent, a rate nearly double historic norms.[4] Homeowners avoiding foreclosure, but still losing their homes in preforeclosure sales (short sales) or deeds-in-lieu (DIL) transactions further add to this crisis.[5]

Foreclosures, and in many respects the foreclosure alternatives mentioned above, have consequences beyond the families who lose their homes. They affect the neighbors who must live next to vacant homes and suffer decreased property values as a result.[6] They

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[1] U.S. Census Bureau, *American Housing Survey for the United States: 2007* (2007) (Table 3–15. Mortgage Characteristics—Owner-Occupied Units) (online at www.census.gov/hhes/www/housing/ahs/ahs07/tab3-15.pdf) (hereinafter "Census Housing Survey"); U.S. Department of Housing and Urban Development, *U.S. Housing Market Conditions*, at 24 (Aug. 2009) (online at www.huduser.org/periodicals/ushmc/summer09/nat_data.pdf).

[2] HOPE NOW, *Workout Plans (Repayment Plans + Modifications) and Foreclosure Sales July 2007—August 2009*, at 1 (2009) (online at www.hopenow.com/industry-data/HOPE%20NOW%20National%20Data%20July07%20to%20Aug09.pdf). (hereinafter "HOPE NOW, Workout Plans and Foreclosure Sales").

[3] Goldman Sachs Global ECS Research, *Global Economics Paper No. 177, Home Prices and Credit Losses: Projections and Policy Options*, at 16 (Jan. 13, 2009) (online at docs.google.com/gview?a=v&q=cache%3AQlc0g0CzRpEJ%3Agarygreene.mediaroom.com%2Ffile.php%2F216%2FGlobal%2BPaper%2BNo%2B%2B177.pdf+Goldman+Sachs+Global+ECS+Research%2C+Global+Economics+Paper+No.+177%2C+Home+Prices+and+Credit+Losses%3A+Projections+and+Policy+Options&hl=en&gl=us&sig=AFQjCNGp3ZHbpbCgjpZh2_17Dv-BpFzCCg).

[4] Mortgage Bankers Association, *National Delinquency Survey*, at 1 (Aug. 2009) (hereinafter "MBA National Delinquency Survey"). Between 1996 and 2008, residential mortgage delinquency rates averaged an annual 4.8 percent surveyed. *Id*.

[5] According to a July 2009 real estate agent survey, 14 percent of all home purchases stemmed from "short sales." Campbell Surveys, *Real Estate Agents Report on Home Purchases and Mortgages—2009* (online at www.campbellsurveys.com/AgentSummaryReports/AgentSurveyReportSummary-June2009.pdf) (accessed Sept. 28, 2009) (hereinafter "Campbell Real Estate Agent Survey").

[6] The Center for Responsible Lending estimates that "in 2009 alone, foreclosures will cause 69.5 million nearby homes to suffer price declines averaging $7,200 per home and resulting in a $502 billion total decline in property values." Center for Responsible Lending, *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average* (May 7, 2009) (online at www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf); John P. Harding et al., The Contagion Effect of Foreclosed Properties (July 13, 2009) (online at www.business.uconn.edu/Realestate/publications/pdf%20documents/406%20contagion_080715.pdf). The Panel held a field hearing in Philadelphia, Pennsylvania on September 24, to examine foreclosure mitigation efforts under TARP. The Panel heard testimony from representatives of Treasury, the GSEs, community housing organizations, loan servicers, an economist, and Judge Annette M. Rizzo of the Philadelphia Court of Common Pleas. The Panel also heard statements from audience members, some of whom high-

Continued

alter the composition of schools and religious institutions, which see children and congregants uprooted.[7] They harm the foreclosing bank, depressing its balance sheet.[8] They drive down housing prices by flooding the market with bank-owned properties.[9] They negatively affect the economy as a whole by decreasing stability in banks, communities, and municipal and state tax bases.[10] Successfully addressing the foreclosure crisis is key to reviving banks, reversing the fall in real estate prices, and promoting economic growth and stability.[11]

light this issue. Congressional Oversight Panel, Statements from the Audience, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 154 (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm).

[7] An estimated 2 million children will lose their homes to foreclosure. "[C]hildren who experience excessive mobility, such as those impacted by the mortgage crisis, will suffer in school." FirstFocus, *The Impact of the Mortgage Crisis on Children* (Apr. 30, 2008) (online at www.firstfocus.net/Download/HousingandChildrenFINAL.pdf) (citing Russell Rumberger, *The Causes and Consequences of Student Mobility*, Journal of Negro Education, Vol. 72, No. 1, at 6–21, (2003)).

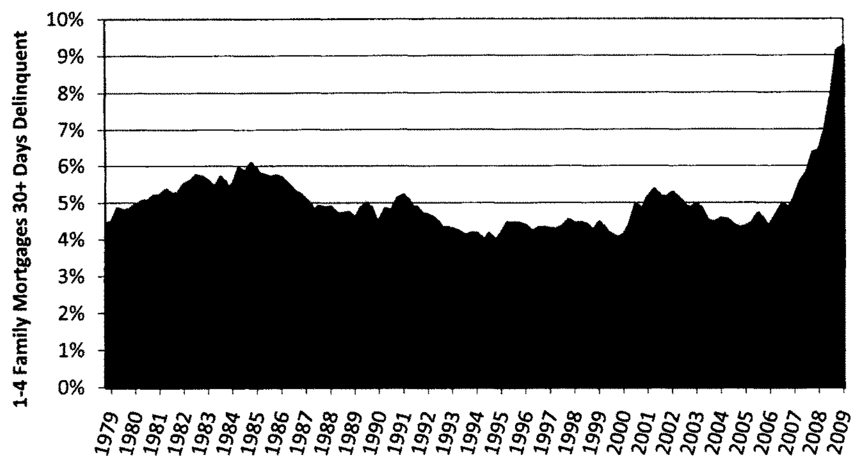
[8] Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets* (Aug. 11, 2009) (online at cop.senate.gov/documents/cop-081109-report.pdf); Laurie Kulikowski, *Citi Execs Offer Optimism, Thin Details*, TheStreet.com (Sept. 14, 2009) (online at www.thestreet.com/story/10598384/1/citi-execs-offer-optimism-thin-details.html) (Citigroup CEO Vikram Pandit "noted that two particularly troubling businesses for the company are the credit card and mortgage portfolios. 'When we see those assets turn, I think you will start to see a change in the profitability of Citi.' ").

[9] Lender Processing Services, *LPS Releases Study That Demonstrates Impact of Foreclosure Sales on Home Prices* (Sept. 3, 2009) (online at www.lpsvcs.com/NewsRoom/Pages/20090903.aspx).

[10] In April 2008, the Pew Charitable Trusts estimated that "10 states alone will lose a total of $6.6 billion in tax revenue in 2008 as a result of the foreclosure crisis, according to a 2007 projection." Pew Charitable Trusts, *Defaulting on the Dream: States Respond to America's Foreclosure Crisis* (Apr. 2008) (online at www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Subprime__mortgages/defaulting__on__the__dream.pdf) (hereinafter "Pew Default on the Dream Article").

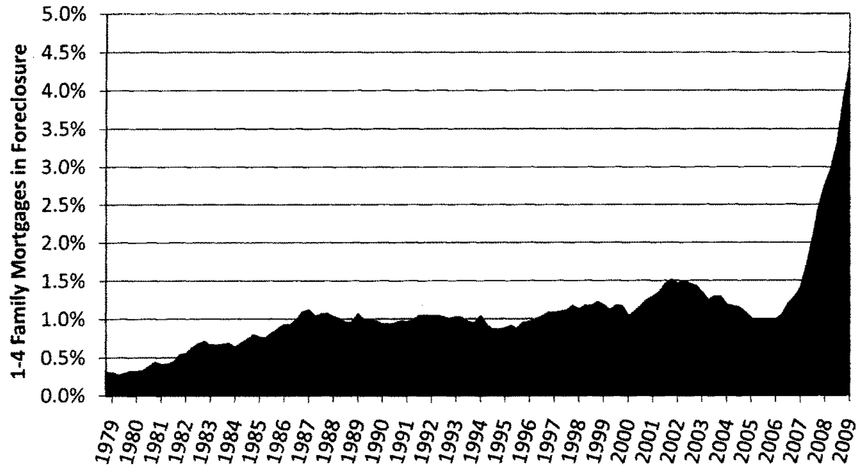
[11] Federal Reserve Board of Governors, *Remarks as Prepared for Delivery by Governor Randall S. Kroszner at NeighborWorks America Symposium* (May 7, 2008) (online at www.federalreserve.gov/newsevents/speech/kroszner20080507a.htm) ("[D]iscussion of the impact of foreclosures on neighborhoods and what can be done to mitigate those impacts is not only timely, it is essential to promoting local and regional economic recovery and growth. . . .").

Figure 1: Percentage of Single Family Residential Mortgages Delinquent[12]



[12] MBA National Delinquency Survey, *supra* note 4.

Figure 2: Percentage of Single Family Residential Mortgages in Foreclosure[13]



1. Waves of Foreclosure

There is still significant debate about the causes of foreclosure and the obstacles faced by foreclosure mitigation programs, but it is inescapable that a large number of American families are losing their homes. The foreclosure crisis began with home flippers, speculators, reach borrowers who purchased or refinanced properties with little money down and non-traditional mortgage products, and homeowners who were sold subprime refinancings.[14] Increasingly, however, because of the severity of the recession, declines in home prices, and the persistence of job losses, foreclosures involve families who put down 10 or 20 percent and took out conventional, conforming fixed-rate mortgages to purchase or refinance homes that in normal market conditions would be within their means.[15]

a. Speculators

The foreclosure crisis has gone in waves of defaults. While these waves are not entirely distinct, they are useful for understanding the course of the crisis and where it is headed. The first wave was centered around real estate speculators, who often borrowed 100 percent or more of property values.[16] When home sales slowed and then as property values began to drop, these speculators simply stopped paying their mortgages and abandoned their properties be-

[13] MBA National Delinquency Survey, *supra* note 4.
[14] U.S. Department of Housing and Urban Development, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (Apr. 2000) (online at www.huduser.org/Publications/pdf/unequal_full.pdf).
[15] MBA National Delinquency Survey, *supra* note 4.
[16] Michael Brush, *Coming: A 3rd Wave of Foreclosures, MSN Money* (June 3, 2009) (online at articles.moneycentral.msn.com/Investing/CompanyFocus/coming-a–3rd-wave-of-foreclosures.aspx). While speculators often took out loans with loan-to-value (LTV) ratios of 100 percent or more, other borrowers also utilized high LTV loans, such as borrowers in high cost areas, borrowers unable or unwilling to make a standard 20 percent down payment, and those utilizing cash-out refinancings. Some speculators may have made false assertions of primary residence or exaggerated income.

cause the carrying costs of the mortgages were greater than the appreciation they anticipated realizing on sale.

b. Hybrid ARMs

The second wave was caused by payment reset shock, primarily from the expiration of teaser rates on hybrid ARMs. Hybrid ARMs have a fixed low teaser interest rate for one to three years, and then an adjustable interest rate that is usually substantially higher. (These loans are often called 2/28s or 3/27s. The first number refers to the length of the teaser period in years, and the second number to the post-teaser term of the mortgage.) The teaser rates on hybrid ARMs made the mortgages for the teaser period quite affordable.

Many hybrid ARMs were subprime loans, meaning that their post-teaser interest rate was substantially above-market. Most of these loans also carried stiff prepayment penalties, making refinancing expensive for the borrower.[17] Sometimes this was because of the risk posed by the borrower. Sometimes the homeowner was willing to assume the high post-teaser rate in exchange for the below-market teaser, as the homeowner anticipated refinancing or selling the appreciated property before the teaser expired. To refinance a mortgage (or to sell the property without a loss) requires having sufficient equity in the property. Many hybrid ARMs were made at very high loan-to-value ratios, as both lenders and homeowners anticipated a rapid accumulation of home equity in the appreciating market of the housing bubble. When the market fell, however, these homeowners lacked the equity to refinance, and often faced prepayment penalties if they did, further decreasing their ability to refinance. Additionally, there are allegations that some prime borrowers were misled into taking out these mortgages.

The result was that many homeowners with hybrid ARMs were unable to refinance out of their loans when the teaser period expired and had to start paying at the substantially higher post-teaser interest rate. Most of these loans had been underwritten based on an ability to pay only the teaser rate, and not the reset post-teaser rate. In many cases, even the teaser rate underwriting was a stretch. When the rates reset, monthly payments on these mortgages often became unaffordable, resulting in defaults.

The teaser rates on most of the hybrid ARMs made in 2005 and 2006 have already expired, and low interest rates now mitigate some of the payment shock on the remaining resets. As a result, the defaults from this wave have already crested, although not all of the defaults have yet resulted in completed foreclosure sales. In

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[17] Michael LaCour-Little & Cynthia Holmes, *Prepayment Penalties in Residential Mortgage Contracts: A Cost-Benefit Analysis*, Housing Policy Debate (2008) (online at www.mi.vt.edu/data/files/hpd%2019.4/little-holmes__web.pdf). The authors' literature review showed that most subprime loans carry a pre-payment penalty, and that "lenders and many economists view prepayment penalties as a mechanism to increase the predictability of cash flow from mortgage loans, thereby enhancing their value to investors and reducing the cost of credit to borrowers." LaCour-Little and Holmes' cost-benefit analysis found that prepayment penalties had significant economic value to lenders and investors, and that the "expected cost of prepayment penalties to borrowers is larger than the benefit, although this cost varies depending on the interest rate environment." *Id*. at 668. For example, they found that "for a loan originated in 2002 with a two-year penalty period, . . . the average interest savings was $418, compared with an expected penalty cost of $3,923—an almost 10-fold difference." *Id*. at 667.

addition, some homeowners who have managed to make the post-reset payments thus far may still default, elevating future foreclosure levels.

c. Negative Equity

A third and on-going wave of defaults has been related to negative equity. A homeowner with negative equity owes more in mortgage debt than his or her home is worth. Steep declines in housing prices below pre-crisis levels and the drag on neighborhood housing prices caused by nearby foreclosures have combined to force a growing number of homeowners into this category.[18] In cases where homeowners have edged into negative equity, some may undertake home improvements to increase the sale price of their property or at least to offset further price erosion. Conversely, homeowners with substantial negative equity may reason that any money they invest in the property, including basic repairs, does not meaningfully add to their equity, but, rather, is value that accrues to the lender. Therefore, homeowners with substantial negative equity have diminished incentives to care for their properties, which further decreases property values.[19] Until they regain positive equity, any money they invest in their properties, including basic repairs, is value that accrues to the lenders in terms of increased collateral value. Until that point, the homeowner becomes at best less underwater, although the homeowner will continue to get the consumption value of the property. Homeowners with negative equity thus have diminished incentives to care for their properties, which further decreases property values.[20]

Homeowners with negative equity are also constrained in their ability to move, absent abandoning the house to foreclosure. There is a wide range of inevitable life events that necessitate moves: the birth of children, illness, death, divorce, retirement, job loss, and new jobs. When one of these life events occurs, if a homeowner has negative equity, the primary choices are between forgoing the move, finding the cash to make up the negative equity, or losing the house in foreclosure. Many have chosen the foreclosure route.

Unfortunately, as the Panel has previously observed, foreclosures push down the prices of nearby properties, which can in turn result in negative equity that begets more defaults and foreclosures.[21] A negative feedback loop can develop between foreclosures and negative equity. To the extent that negative equity alone may produce foreclosures, progress in addressing loan affordability will have a limited impact on foreclosure rates over the long term.

Negative equity may also be a factor (along with unemployment) contributing to historically low self-cure rates on defaulted mortgage loans. Historically, self-cure rates on mortgage defaults were fairly high; nearly half of all prime defaults would cure on their

[18] 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").

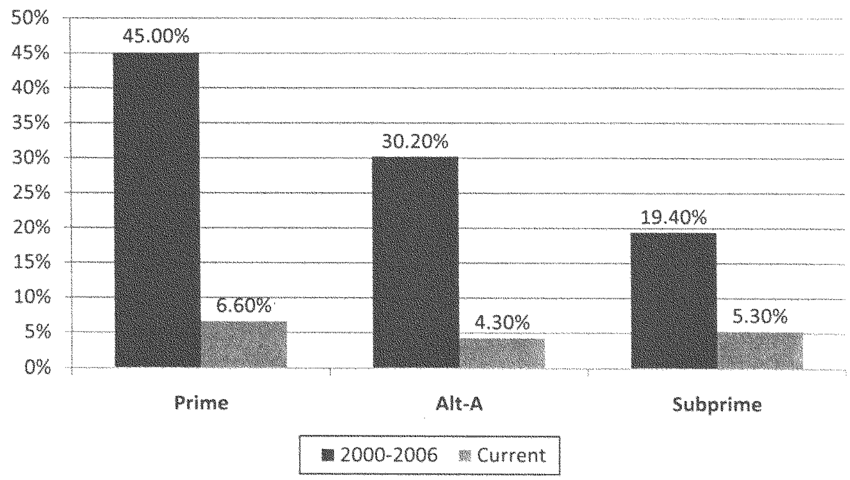
[19] M.P. McQueen, *Are Distressed Homes Worth It*, Wall Street Journal (Oct. 1, 2009) (online at online.wsj.com/article/SB10001424052970203803904574430860271702396.html).

[20] *Id*.

[21] Congressional Oversight Panel, *The Foreclosure Crisis: Working Toward a Solution*, at 9 (Mar. 6, 2009) (online at cop.senate.gov/documents/cop–030609–report.pdf) (hereinafter "COP March Oversight Report.")

own. Currently, however, self-cure rates for all types of mortgage products are extremely low (Figure 3). A homeowner with negative equity may well decide that the financial belt-tightening necessary to cure a default simply is not worth it or not possible. The homeowner might rationally conclude that it is better for him or her to save the monthly payments and relocate to a less expensive rental.

Figure 3: Mortgage Default Self-Cure Rates[22]



Estimates as to the number of households with negative equity vary, but they are all dire. Many estimates also exclude homeowners with minimal positive equity, borrowers who would likely take a loss upon a sale after paying brokers' fees and taxes. Currently, around one-third of all residential mortgage borrowers have negative equity and another five percent have near negative equity.[23] Deutsche Bank also estimated that 14 million homeowners had negative equity as of the first quarter of 2009,[24] while Moody's Economy.com placed the estimate at 15 million for that quarter.[25] Looking forward, Moody's projects that by 2011, some 18 million homeowners will have negative equity,[26] while Deutsche Bank projects a figure of as many as 25 million, or one-half of all homeowners with a mortgage.[27] The estimations vary by loan product type, but even for conventional, conforming prime mortgages, Deutsche Bank estimates that 41 percent of mortgagors will have nega-

[22] Fitch Ratings, *Delinquency Cure Rates Worsening for U.S. Prime RMBS* (Aug. 24, 2009) (hereinafter "Fitch Release").

[23] CoreLogic Negative Equity Data, supra note 18.

[24] Deutsche Bank, *Drowning in Debt—A Look at "Underwater" Homeowners*, at 2 (Aug. 5, 2009) (available online at www.sacbee.com/static/weblogs/real_estate/Deutsche%20research%20on%20underwater%20mortgages%208-5-09.pdf) (hereinafter "Deutsche Bank Debt Report").

[25] Id.

[26] Henry Blodget, The Business Insider, *Half of US Homeowners Will be Underwater by 2011* (online at www.businessinsider.com/henry-blodget-half-of-us-homeowners-underwater-by-2011-2009-8#now-14-million-underwater-next-year-25-million-1) (accessed Oct. 5, 2009) (hereinafter "Blodget Underwater Homeowners Report").

[27] The US Census Bureau estimates there to be 76 million home-owning households and approximately two-thirds of them (52 million) have mortgages. Census Housing Survey, *supra* note 1.

tive equity by the first quarter of 2011.[28] As a comparison, Deutsche Bank estimates that 16 percent of borrowers with conventional, conforming prime mortgages currently have negative equity.[29]

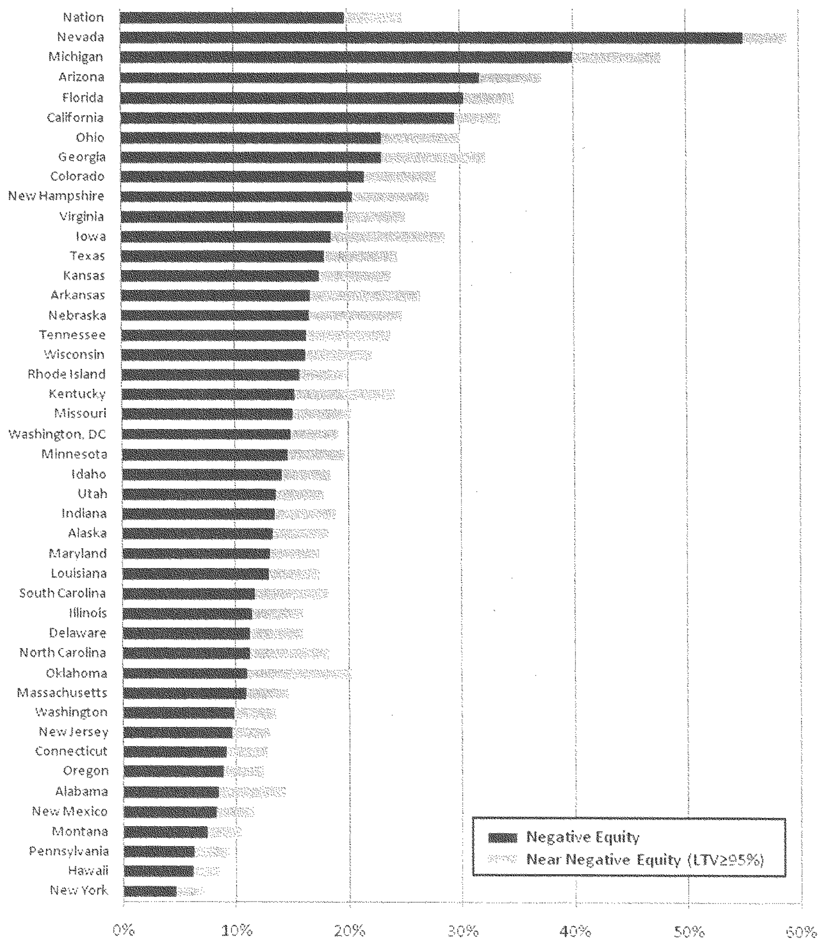
The negative equity situation also varies significantly by state. (See Figure 4 below.) While some states like New York and Hawaii have low levels of negative equity, in others, like Nevada, Michigan, Arizona, Florida, California, Ohio, and Georgia, the situation is particularly grim, with anywhere from 30 percent to 59 percent of homeowners currently having little or no equity in their homes. As punctuated by expert testimony at the Panel's Clark County field hearing in December 2008, such situations, when combined with a catalyst such as rising unemployment, pose "a great risk going forward if the economy does not pick up."[30]

[28] Deutsche Bank Debt Report, *supra* note 24.

[29] Deutsche Bank Debt Report, *supra* note 24.

[30] At the time, Dr. Keith Schwer testified that 50 percent of Nevada homeowners had negative mortgage equity. He also stated his belief that unemployment was likely to reach 10 percent in 2009. Congressional Oversight Panel, Testimony of Director of the University of Nevada, Las Vegas' Center for Business and Economic Research, Dr. Keith Schwer, *Clark County, NV: Ground Zero of the Housing and Financial Crises* (Dec. 16, 2008) (online at cop.senate.gov/documents/transcript-121608-firsthearing.pdf).

Figure 4: Percentage of Homes with Negative Equity as of December 2008[31,32]



[31] CoreLogic Negative Equity Data, *supra* note 18.

[32] No data was reported for Maine, Mississippi, North Dakota, South Dakota, Vermont, West Virginia, and Wyoming.

d. Interest-Only and Payment-Option Mortgages

Two additional, and simultaneous, waves of foreclosure still stand ahead of us. These are expected to come from payment shocks due to rate resets on two classes of non-traditional mortgage products: interest-only and payment option mortgages. Interest-only mortgages, whether fixed or adjustable rate, have an initial interest-only period, typically five, seven or ten years, during which the borrower's required minimum monthly payments cover only interest, not principal. After the expiration of the interest-only period, the monthly payment rate resets with the principal amortized over the remaining loan terms (typically 20 to 25 years). The result is that after the interest-only period expires, the monthly payment may be significantly higher.

Payment-option loans (virtually all ARMs keyed to an index rate) are similar. Payment-option ARMs permit the borrower to choose the level of monthly payment during the first five years of the loan. Typically there are four choices—(1) as if the loan were amortizing over 15 years; (2) as if the loan were amortizing over 30 years; (3) interest-only (non-amortizing); and (4) negatively amortizing. Payment-option ARMs generally have negative amortization limits. If there is too much negative amortization (usually 10–15 percent), then the loan will be recast into a fully amortizing ARM for the remaining term of the mortgage. If the negative amortization trigger is not tripped first, the loan will recast after five years into a fully-amortizing ARM with rates resetting every six to 12 months thereafter based on an index rate. In either case, the monthly payment will increase significantly.

Historically, interest-only and payment-option loans were niche products, but they boomed during the housing bubble. Countrywide Financial, the nation's largest mortgage lender, originated primarily payment-option ARMs during the bubble.[33] Twenty percent of the dollar amount of mortgages originated between 2004 and 2007 was either payment-option or interest-only.[34] First American CoreLogic calculates that there are presently 2.8 million active interest-only home loans with an outstanding principal balance of $908 billion.[35]

Most interest-only and payment-option mortgages were not subprime loans.[36] Instead, they were made to prime borrowers, but were often underwritten with reduced documentation, making

[33] U.S. Securities and Exchange Commission, *Countrywide Financial Corporation*, *Form 10–Q* (June 30, 2008) (online at www.sec.gov/Archives/edgar/data/25191/000104746908009150/a2187147z10–q.htm).

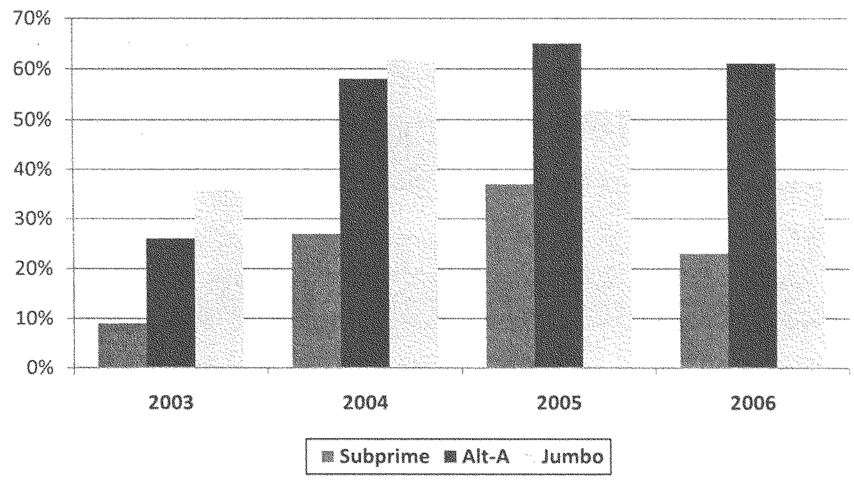
[34] Inside Mortgage Finance Publications, *Mortgage Market Statistical Annual*, *Volume I: The Primary Mortgage Market* (2009). The dollar amount of these mortgages currently outstanding is unknown, but total originations from 2004–2007 were roughly equal to the total amount of mortgage debt outstanding at the end of 2007. It is therefore likely that even with some pay-options and interest only loans being refinanced in this time period, that they comprise about a fifth of the dollar amount of mortgages outstanding. *Id.*

[35] The problems associated with interest-only loans were the subject of a First American CoreLogic analysis commissioned by the New York Times. David Streitfeld, *As an Exotic Mortgage Resets*, *Payments Skyrocket*, New York Times (Sept. 8, 2009) (hereinafter "Streitfeld Mortgage Resets Article").

[36] Oren Bar-Gill, *The Law*, *Economics and Psychology of Subprime Mortgage Contracts*, 94 Cornell L. Rev. 1073, 1086 (Nov. 2009) (online at papers.ssrn.com/sol3/papers.cfm?abstract__id=1304744).

them so-called "Alt-A" loans.[37] Many were also jumbos, meaning that the original amount of the loan was greater than the Fannie Mae/Freddie Mac conforming loan limit.[38] (See Figure 5.) This means, among other things, that many of these homeowners are not eligible for assistance from the Making Home Affordable Program because their mortgages are above the maximum eligible amount, although recent increases in the conforming loan limit for certain high-cost areas have expanded eligibility.

Figure 5: Characteristics of Interest-Only and Payment-Option Mortgages[39]



Payment-option and interest-only mortgages are typically 5/1s, meaning that they have a rate reset after five years and additional resets once each following year. This means that mortgages of this type originated in 2004–2007 will be experiencing rate resets in 2009–2012. (See Figure 6.) Assuming that long-term low interest rates continue, they will mitigate the payment reset shock on adjustable rate payment-option and interest-only mortgages.[40] But there will inevitably be a sizeable payment shock simply from the kick-in of the full amortization period, and the homeowners may

[37] Credit Suisse, *Research Report: Mortgage Liquidity du Jour: Underestimated No More* (Mar. 12, 2007) (online at www.scribd.com/doc/282277/Credit-Suisse-Report-Mortgage-Liquidity-du-Jour-Underestimated-No-More-March–2007) (hereinafter "CS Mortgage Liquidity Report").

[38] *Id.* The conforming loan limit in certain high-cost areas was raised from $417,000 to $729,750 in 2008, which means that certain loans that would have been have previously been jumbo loans are now conforming and therefore eligible to be modified under the Home Affordability Modification Program (HAMP). Fannie Mae, *Historical Conventional Loan Limits* (July 30, 2009) (online at www.fanniemae.com/aboutfm/pdf/historicalloanlimits.pdf).

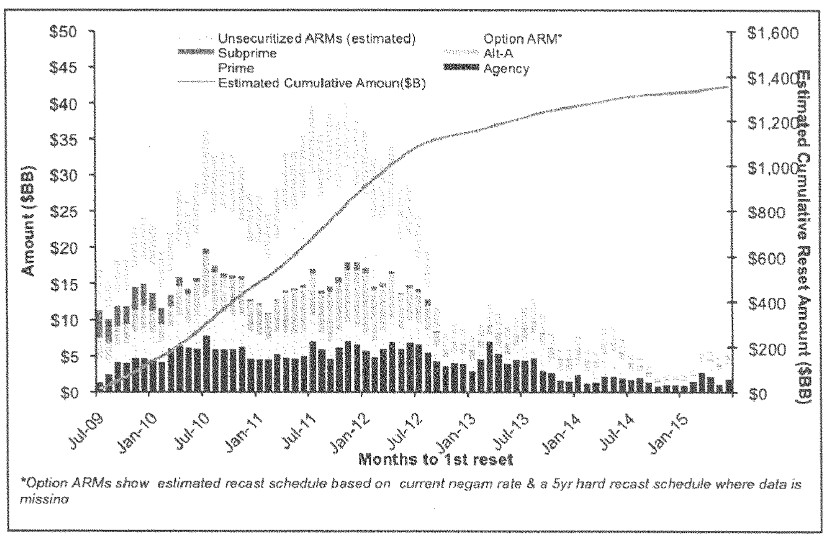
[39] CS Mortgage Liquidity Report, *supra* note 37.

[40] If long term interest rates rise, there could be higher numbers of defaults on these adjustable mortgages. One factor causing the low rates is the Federal Reserve's buying of GSE securities. As part of its monetary policy, the Federal Reserve purchases GSE securities, therefore putting money into the economy and keeping interest rates low. David A. Moss, *A Concise Guide to Macroeconomics*, at 36–37 (Harvard Business School Press 2007) (providing a general overview of economic policy). It is unclear whether this intervention on the part of the Federal Reserve can sustain low mortgage interest rates through the 2010–2012 period when the next round of resets will occur. In addition, continued low interest rates will not protect holders of Alt-A mortgages who have negative equity and no savings with which to cover the gap between home value and mortgage. Other factors affecting interest rates include the condition of the U.S. economy (interest rates rise as the demand for funds increases and fall when the demand for funds is low), inflationary or deflationary pressures, the involvement of foreign investors willing to lend money to the United States, and fluctuations in exchange rates. *Id.* at 34–39.

not have the income or savings to cover the increase in payments, and if they have negative equity, will not be able to refinance into a more stable product.[41]

The impact on the number of foreclosures from recasts of interest-only and payment-option mortgages is likely to be at least as great as those from subprime hybrid ARMs, as shown by Figure 7, a graph from Credit Suisse showing anticipated rate resets for different types of mortgages. These peaks might be softened only because a large number of payment-option ARM mortgagors are already in default; the Office of the Comptroller of the Currency and the Office of Thrift Supervision (OCC/OTS) Mortgage Metrics, which cover two-thirds of the market, indicate that a quarter of all payment-option ARMs are seriously delinquent or in foreclosure,[42] while Deutsche Bank indicates nearly 40 percent of outstanding payment-option ARMs are already 60+ days delinquent.[43] Not coincidentally, more than 77 percent of payment-option ARMs have negative equity presently.[44]

Figure 6: Months Before Anticipated Mortgage Rate Reset[45]



[41] Streitfeld Mortgage Resets Article, *supra* note 35.

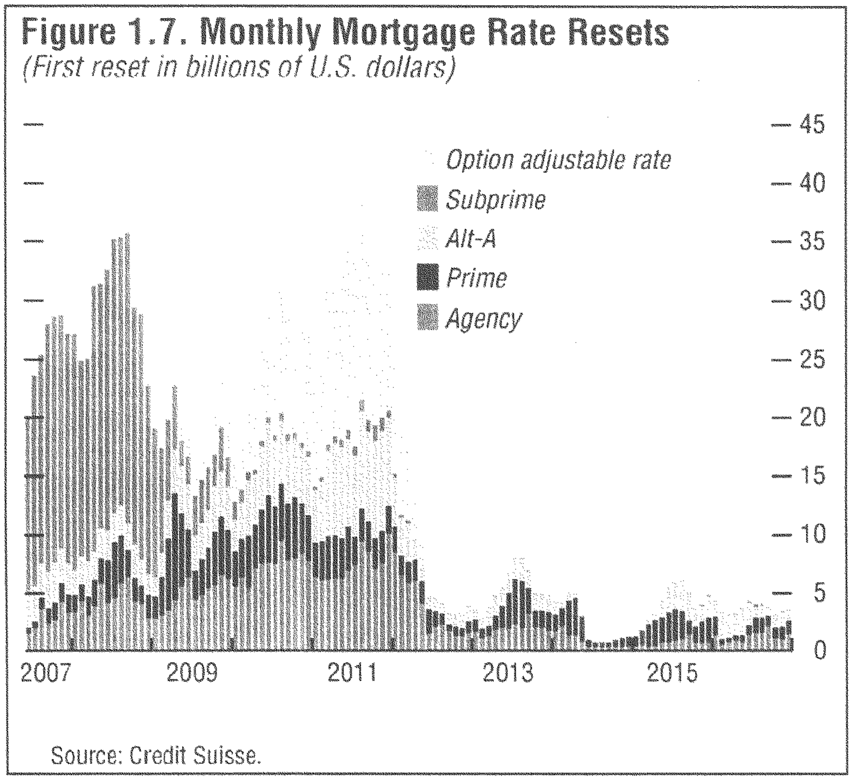
[42] Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, Second Quarter 2009*, at 17 (Sept. 21, 2009) (online at files.ots.treas.gov/482078.pdf) (hereinafter "OCC and OTS Second Quarter Mortgage Report").

[43] Deutsche Bank, *Global Economic Perspectives: Housing Turning Slowly*, at 8 (Sept. 9, 2009).

[44] Blodget Underwater Homeowners Report, *supra* note 26.

[45] Henry Blodget, Business Insider, *The "Coming Alt-A Mortgage Reset Bomb" Is A Myth* (Aug. 28, 2009) (online at www.businessinsider.com/henry-blodget-the-coming-alt-a-mortgage-reset-bomb-is-a-myth-2009-8).

Figure 7: Monthly Mortgage Rate Resets[46]



e. Unemployment

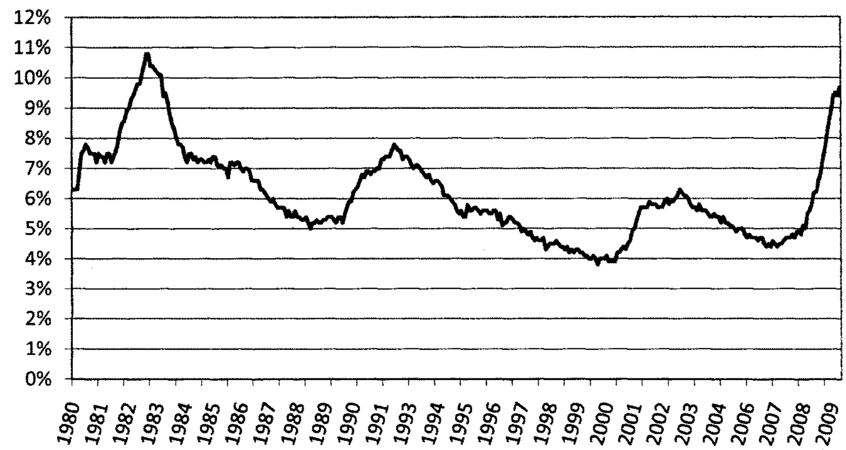
A fifth wave of foreclosures is now occurring, driven by unemployment. The current unemployment rate of 9.8 percent has more than doubled since the beginning of 2007, when foreclosure rates began to rise. (See Figure 8, below.) As Figure 9 shows, unemployment and foreclosure rates have generally been moving together since 2000. When a household loses an income, even temporarily, the likelihood of a mortgage default rises sharply. Some households are able to continue making payments out of a second income, from savings, or from unemployment insurance payments, but most mortgage lenders will not accept partial payments. When reduced household income is combined with negative equity, payment reset shock, or both, default is nearly inevitable. Moreover, continued unemployment makes self-cure of defaults much less likely. (See *supra* section 1(c)).

Unemployment does not discriminate by mortgage product type. Defaults are now affecting the conventional prime market, jumbo prime, second lien, and home equity line of credit (HELOC) markets; the defaults are being driven by unemployment and negative

[46] CS Mortgage Liquidity Report, *supra* note 37.

equity, rather than payment reset shock. Prime defaults and foreclosures began to surge at the close of 2008 and have continued to rise into 2009.[47] (See Figure 10, below.) Even as foreclosures seem to be abating at the bottom of the market, defaults are soaring at the top of the market. What began as a subprime problem is now truly a national mortgage problem.

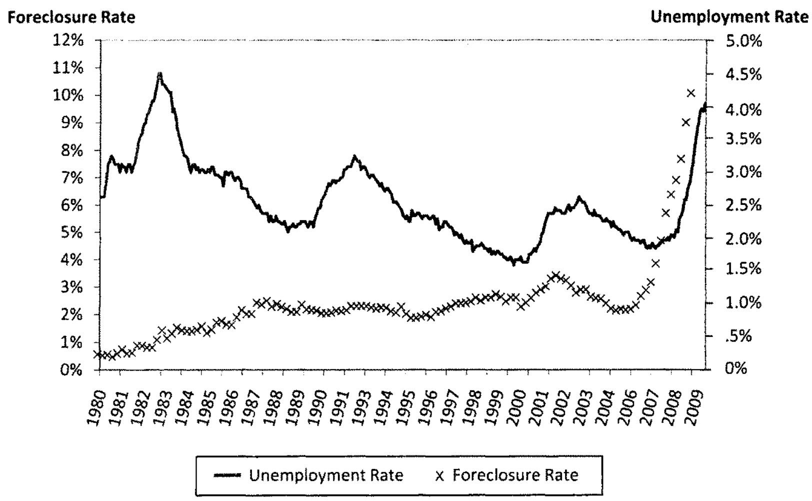
Figure 8: United States Unemployment Rate (1980-present)[48]



[47] MBA National Delinquency Survey, *supra* note 4. Lender Processing Services, *Lender Processing Services' August Mortgage Monitor Report Shows Increased Foreclosure Starts But Greater Loss Mitigation Success* (Sept. 1, 2009) (online at www.lpsvcs.com/NewsRoom/Pages/20090901.aspx); American Bankers Association, *Consumer Delinquencies Rise Again in First Quarter 2009: Composite Ratio Inches Higher, Sets New Record* (July 7, 2009) (online at www.aba.com/Press+Room/070709DelinquencyBulletin.htm).

[48] U.S. Bureau of Labor Statistics, Household Data Historical, *A–1 Employment Status of the Civilian Non-Institutional Population 16 Years and Over, 1970 to Date* (online at ftp://ftp.bls.gov/pub/suppl/empsit.cpseea1.txt) (accessed Oct. 7, 2009).

Figure 9: United States Unemployment Rate and Foreclosures (1980-present)[49]

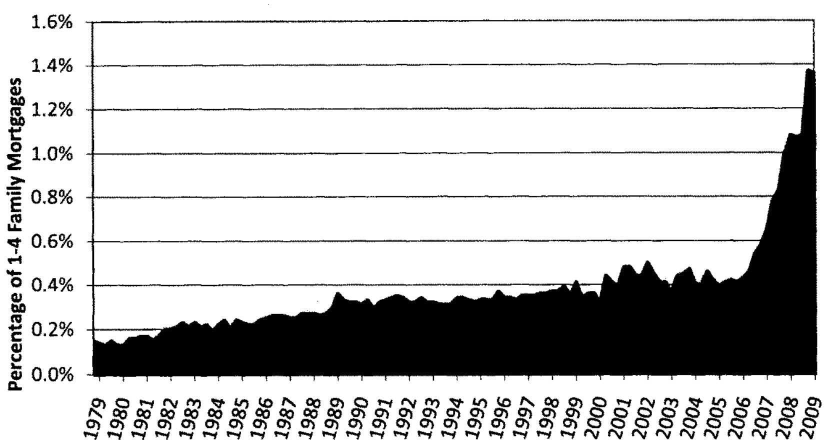


2. Mixed Signs in the Housing Market

Recently, there have been some positive signs in the housing sector. First, although foreclosure inventories have grown, the pace of foreclosure initiations remained static from the fourth quarter of 2008 to the first quarter of 2009 (1.37 percent in Q4 2008 and 1.36 percent in Q1 2009). (See Figure 10.) It is hard, however, to read too much into a particular quarter's data, and foreclosure starts remain at a near record level. The static level of foreclosure starts does not represent the impact of the Making Home Affordable Program, as that program was not announced until late in the quarter and did not become operational until April 2009. To the extent that the slowed foreclosure starts are not simply a data fluke, one tenable explanation is that we have reached a limit in the legal system's capacity to handle foreclosure initiations. Other possible reasons include good-faith efforts by servicers to enter into modifications, foreclosure moratoria, servicer capacity issues, and the possibility that mortgage servicers are intentionally postponing foreclosure filings to delay loss recognition for accounting purposes.[50]

[49] MBA National Delinquency Survey, *supra* note 4.
[50] Kate Berry, American Banker, *Postponing the Day of Reckoning* (Aug. 26, 2009) (online at www.financial-planning.com/news/postponing-reckoning-foreclosure–2663681–1.html).

Figure 10: Foreclosure Starts by Quarter[51]



A more encouraging sign is that housing price indices are flattening and even moving upward, although there is significant regional and market sector variation.[52] Even as prices rebound for the lower end of the housing market, defaults are increasing on the top end,[53] and some markets, like Phoenix and Las Vegas, continue to see precipitous housing price declines.[54]

Several factors appear to have contributed to the price increases. Low interest rates and the new first-time home buyer tax credit have combined with declines in housing prices to make home purchases more affordable.[55] Given such policies, the National Association of Realtors Affordability Index is at a historic high. Moreover, the glut in housing supply is slackening as the stock of new homes for sale is running off rapidly. Yet foreclosures and distressed sales continue to keep inventory levels high, which pushes down prices. In recent months, one-third of home sales have been foreclosures

[51] MBA National Delinquency Survey, *supra* note 4.

[52] Standard & Poor's, *Broad Improvement in Home Price According to the S&P/Case-Shiller Home Price Indices* (Sept. 29, 2009) (online at www2.standardandpoors.com/spf/pdf/index/CSHomePrice_Release_092955.pdf).

[53] By July 2009, foreclosure starts for jumbo mortgages were happening at more than three times the rate they were occurring in January 2008. Lender Processing Services (LPS), *Mortgage Monitor: August 2009 Mortgage Performance Observations*, at 21 (online at www.lpsvcs.com/NewsRoom/IndustryData/Documents/09–2009%20Mortgage%20Monitor/LPS%20Mortgage%20Monitor%20Aug09%20(2).pdf). The jumbo market will likely continue to underperform without increased activity in the private-label secondary market or bank lending. This means that foreclosure rates for jumbo mortgages are likely to stay higher than normal. Because Fannie and Freddie will not buy jumbo loans, and with the sharp decline of the private-label securities market, banks have little appetite for originating jumbos. Consequently, jumbos have fallen from around 15 percent of the mortgage market to a mere 2.3 percent. The diminished availability of credit for the purchase of expensive homes has been one factor in the decline in prices at the top end of the market. PMI, *The Housing & Mortgage Market Review* (July 2009) (online at www.pmi-us.com/PDF/jul_09_pmi_hammr.html).

[54] Nationally, a 10.21 percent decline in home prices in the 12 months ending in April 2009 masked a wide range of trends in the states. The largest price declines were in Nevada (26.05 percent), Florida (23.15 percent), California (22.72 percent), and Arizona (20.51 percent). The largest price increases were in West Virginia (5.27 percent), New York (3.88 percent), and Louisiana (3.10 percent). *Id.*

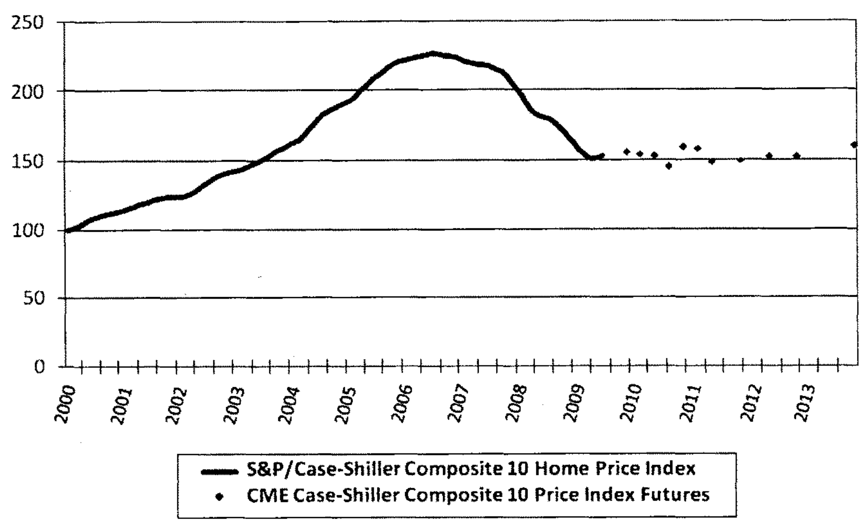
[55] The new homebuyer tax credit will expire on December 1, 2009. Some observers are concerned about the effect of this expiration. Dina ElBoghdady, *Clock Is Ticking for First-Home Buyers*, Washington Post (Sept. 25, 2009) (online at www.washingtonpost.com/wp-dyn/content/article/2009/09/24/AR2009092404936.html).

or short sales.[56] Moreover, when government support for the housing market is withdrawn, there will also necessarily be more downward pressure on home prices.

While there are encouraging signs, it is hard to read them as anything more than a possible bottoming out of the housing market, rather than a true recovery. Housing price index futures show that the market does not expect any significant gain in home prices for a few years. U.S. housing market futures based on the Case-Shiller Composite 10 Home Price Index are traded on the Chicago Mercantile Exchange. The Index is pegged to January 2000 as 100.

At its peak in April 2006, the Index was at 226.23. In April 2009, the Index was at 150.34, and as of July 2009 the Index stood at 155.85, down 32 percent from peak. The futures market anticipates the Index falling again to a low of 145.00 in August 2010 (down 36 percent from the peak and up 45 percent for the decade) and still not climbing above 160 (down 29 percent from peak) even in November 2013, the latest date on which futures are presently being traded. (The Index stood at 160 in January 2009 and October 2003.) In other words, the market anticipates that the national average housing price will rise only 4 percent from current levels over the next four or five years. (See Figure 11.) While this is certainly better than a continued plunge in housing prices, it also means that the market anticipates that in another four years prices will remain near their seriously depressed values at the beginning of this year.

Figure 11: S&P/Case-Shiller Composite 10 Home Price Index and Chicago Mercantile Exchange Futures on Composite 10 Index (Jan. 1, 2000=100)



Even if prices do not fall further, the downward pressure of continued mass foreclosures may also prevent housing prices from ris-

[56] Diana Golobay, *NAR Offers Realtors Certification for Short Sales, Foreclosures*, Housing Wire.com, (Aug. 26, 2009) (online at www.housingwire.com/2009/08/26/nar-offers-realtors-certification-for-short-sales-foreclosures/).

ing significantly during the next few years. Stagnant housing prices would result in continued negative equity, setting the stage for foreclosures if payments become unaffordable or households need to move. Using housing price futures as an approximate guide to what might be expected in the housing market, many of the families that took out mortgages between 2003 and 2008—even those that put down 20 percent or more and took out standard conforming loans—will have negative equity in their homes into the foreseeable future. If prices remain stagnant during the next four years, then at least one in five of today's U.S. homeowners, if not many more, will have negative equity in their homes, and nearly one in four of them will have so little equity in their homes that they will not be able to cover the costs of selling their properties without a loss. These scenarios could potentially unfold for approximately 15 million and 18 million homeowners, respectively.[57]

Ongoing negative equity presents a problem not just for current foreclosures, but for years into the future. This means more families losing their homes in foreclosure, more losses for lenders and investors in mortgage securitizations (including entities whose debts are guaranteed by the United States government, such as Fannie Mae and Freddie Mac), and more blighted properties for communities. It also means that true stabilization of the U.S. housing market will be delayed, and investors will have difficulty pricing housing investments because of uncertainty about default rates.

It is against this largely discouraging backdrop that the Panel now turns to consideration of foreclosure mitigation efforts.

3. Congressional Efforts to Stem the Tide of Foreclosures

In response to the waves of foreclosures, Congress made foreclosure mitigation an explicit part of the Emergency Economic Stabilization Act (EESA), designed to address the nation's economic crisis.[58] Two of EESA's stated goals are to "preserve homeownership" and "protect home values."[59] In addition, EESA instructs the Treasury Secretary to take into consideration "the need to help families keep their homes and to stabilize communities."[60] It also includes express directions to create mortgage modification programs.[61]

Prior to passage of EESA, Senator Christopher Dodd stated that "Democrats and Republicans . . . warned of a coming wave of fore-

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[57] CoreLogic Negative Equity Data, *supra* note 18. U.S. Census Bureau, *American Housing Survey—Frequently Asked Questions* (online at www.census.gov/hhes/www/housing/ahs/ahsfaq.html) (accessed Oct. 7, 2009). More than 15.2 million mortgages were in negative equity as of June 30, 2009, out of 75.6 million owner-occupied residences, or about 20 percent. More than 17.7 million, or about 23 percent of owner-occupied residences, were in or near negative equity. *Id.*

[58] EESA §§ 2(2)(B), 109, 110, 125(b)(1)(iv). The HOPE for Homeowners Act of 2008, part of the Housing and Economic Recovery Act, Pub. L. No. 110–289, was intended to address the foreclosure crisis, but met with little success. The 2007 FHASecure program was also not adequate to solve the problem. U.S. Department of Housing and Urban Development, *Bush Administration to Help Nearly One-Quarter of a Million Homeowners Refinance, Keep Their Homes* (Aug. 31, 2007) (online at www.hud.gov/news/release.cfm?content=pr07–123.cfm).

[59] EESA § 2(2).

[60] EESA § 103(3).

[61] EESA § 110.

closures that could devastate millions of homeowners and have a devastating impact on our economy." [62]

Senator John Rockefeller added:

> [T]he bill provides relief to homeowners who have been caught up in the current mortgage crisis and are trying to save their homes. The bill starts to address the root of this financial crisis—foreclosures—not by giving a pass to individuals who took out loans they could not afford, but by allowing the Government to renegotiate mortgage terms. Two million more foreclosures are projected in the next year and it is in everyone's interest to bring that number down, keeping more families in their homes and paying off their debts.[63]

Senator Judd Gregg continued, "We focused a lot of attention on making sure that we could keep people in their homes. We don't want people foreclosed on." [64] Senator Max Baucus explained that home ownership "is not an ancillary objective; it is inherent . . . to our efforts to resolve this economic crisis." [65] Senator Jack Reed added that "[i]t is only through helping the homeowners that we will we get to the bottom of the crisis." [66]

In early March 2009, Treasury unveiled the Making Home Affordable (MHA) initiative, implementing the foreclosure mitigation provisions of EESA. MHA consists of two primary programs, the Home Affordable Refinance Program (HARP) and Home Affordable Modification Program (HAMP), along with several subprograms.[67]

B. March Checklist

In its March 2009 report, the Panel set forth a checklist by which it would evaluate future foreclosure modification efforts, particularly MHA. The checklist had eight criteria:

1. Will the plan result in modifications that create affordable monthly payments?
2. Does the plan deal with negative equity?
3. Does the plan address junior mortgages?
4. Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?
5. Does the plan counteract mortgage servicer incentives not to engage in modifications?
6. Does the plan provide adequate outreach to homeowners?
7. Can the plan be scaled up quickly to deal with millions of mortgages?
8. Will the plan have widespread participation by lenders and servicers?

In general, what progress has MHA made in addressing each point?

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[62] Statement of Senator Christopher Dodd, Congressional Record, S10223 (Oct. 1, 2008) (online at frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=2008_record&page=S10224&position=all).
[63] Statement of Senator Jay Rockefeller, Congressional Record, S10433 (Oct. 2, 2008).
[64] Statement of Senator Judd Gregg, Congressional Record, S10217 (Oct. 1, 2008).
[65] Statement of Senator Max Baucus, Congressional Record, S10224 (Oct. 1, 2008).
[66] Statement of Senator Jack Reed, Congressional Record, S10228 (Oct. 1, 2008).
[67] See Sections C1–C5 for a fuller description and discussion of the MHA programs.

1. Affordability

MHA has focused primarily on achieving affordable monthly mortgage payments through a standard for modifications of a 31 percent debt-to-income (DTI) ratio. Under HAMP, the program offering the most information on outcomes, on average, borrowers' DTI went from 47 percent before the modification to 31 percent after, a drop of 34 percent. This translates to a drop in the average payment from $1,554.14 to $955.65, an average savings of $598.49 per month.

The more affordable payments were achieved primarily through reductions in interest rates. On average, rates dropped from 7.58 percent to 2.92 percent. This is noteworthy because under the program, interest rates begin to rise in five years, raising questions about the effect on affordability down the road. The program does not include specific features that address the unemployed. At the current time, MHA has made significant progress in providing more affordable payments for many. For further discussion of affordability issues, see Section C.

2. Negative Equity

While HARP and HAMP can help achieve affordable payments for homeowners with negative equity, neither of MHA's two primary components was primarily designed to address underlying negative equity, although they do have features that address the issue. For example, HAMP does not have a maximum LTV, HARP allows refinancings of performing loans above 100 percent LTV (currently up to 125 percent), and in both programs principal reductions are permitted although not required. HAMP appears to increase negative equity modestly by capitalizing arrearages. Accordingly, average LTV ratios under HAMP increased from 134.13 percent to 136.61 percent. For further discussion of negative equity, see Section D.

3. Second Liens

The MHA initiative contains a second lien program to help overcome the obstacles to modification presented by junior liens. Second liens can interfere with the success of loan modification in several ways. First, unless the second lien is also modified, modifying the first lien may not reduce homeowners' total monthly mortgage payments to an affordable level.[68] Even if the homeowner can afford a modified first mortgage payment, a second unmodified mortgage payment can make the total monthly mortgage payments unaffordable, increasing redefault risk.[69] Second, holders of primary mortgages are often hesitant to modify the mortgage if the second mortgage holder does not agree to re-subordinate the second mortgage to the first mortgage. This can present a significant pro-

[68] Payments on junior liens are not included in the calculation of 31 percent front-end DTI under the HAMP first lien program. Front-end DTI is calculated by summing principal, interest, taxes, insurance, homeowners association fees, and condominium fees, and dividing the total by monthly gross income. Payments on junior liens, along with monthly insurance premiums, payments on credit card debt, alimony, car lease payments, and monthly mortgage payments on second homes, are included in the calculation of back-end DTI.

[69] U.S. Department of the Treasury, *Making Home Affordable: Program Update,* at 1 (Apr. 28, 2009) (online at wwwfinancialstability.gov/docs/042809SecondLienFactSheet.pdf). (hereinafter "MHAP Update").

cedural obstacle to modifying a first lien.[70] Third, second liens also increase the negative equity that can contribute to subsequent redefaults.

According to Treasury, as many as 50 percent of at-risk mortgages also have second liens.[71] Therefore, it is critical that second liens be addressed as part of a comprehensive mortgage modification initiative. Treasury announced a second lien program as part of HAMP. The program will offer incentive payments and cost sharing arrangements to incentivize modification or extinguishment of second liens.

At this time, the Second Lien Program is not yet up and running. While Treasury is currently in negotiations with lenders and servicers covering more than 80 percent of the second lien market, it does not yet have any signed participation contracts for the program. Given the prevalence of second liens and the significant obstacle they can present to successful loan modification, it is critical that Treasury get the program up and running expeditiously. For further discussion of the Second Lien Program, see Section C.

4. PSA Obstacles

The Panel's March 2009 report identified contractual restrictions on loan modification in securitization pooling and servicing agreements (PSAs)[72] as a factor inhibiting loan modification efforts. It is unclear whether Treasury has the authority to abrogate these private contracts, although Treasury could, and already has, conditioned TARP assistance to financial institutions on particular mortgage modification terms. HAMP requires servicers to undertake reasonable attempts to have any contractual obligations revised, but HAMP otherwise defers to contractual requirements imposed on mortgage servicers by PSAs.

Many PSAs are simply vague,[73] however, virtually every PSA restricts the ability to stretch out a loan's term; loan terms may not be extended beyond the final maturity date of the other loans in the pool. Securitized loans are typically all from the same annual vintage give or take a year, which means that the ability to stretch

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[70] *Id.* The Panel addressed the complexities and challenges caused by junior liens in its March Oversight Report. The Panel noted that there are multiple mortgages on many properties, and that across a range of mortgage products, many second mortgages were originated entirely separately from the first mortgage and often without the knowledge of the first mortgagee. In addition, millions of homeowners took on second mortgages, often as home equity lines of credit. Since those debts also encumber the home, they must be dealt with in any viable refinancing effort. As the Panel stated, "The existence of junior mortgages also significantly complicates the refinancing process. Unless a junior mortgagee consents to subordination, the junior mortgage moves up in seniority upon refinancing. Out of the money junior mortgagees will consent to subordination only if they are paid. Thus, junior mortgages pose a serious holdup for refinancings, demanding a ransom in order to permit a refinancing to proceed." COP March Oversight Report, *supra* note 21.

[71] *Id.* Apgar Senate Testimony, *infra* note 183; House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, Written Testimony of FHA Commissioner and U.S. Department of Housing and Urban Development Assistant Secretary for Housing, Dave Stevens, *Progress of the Making Home Affordable Program: What Are the Outcomes for Homeowners and What Are the Obstacles to Success?* (Sept. 9, 2009) (online at www.hud.gov/offices/cir/test090909.cfm) (hereinafter "House Testimony of Dave Stevens").

[72] A PSA is a document that actually creates a residential mortgage-backed securitized trust and establishes the obligations and authority of the servicer as well as some mandatory rules and procedures for the sales and transfers of the mortgages and mortgage notes from the originators to the trust.

[73] John Patrick Hunt, *What Do Subprime Securitization Contracts Actually Say About Loan Modification?,* at 10–11 (Mar. 25, 2009) (online at www.law.berkeley.edu/files/bclbe/Subprime__Securitization__Contracts__3.25.09.pdf) (hereinafter "Hunt Subprime Contracts Paper").

out terms is usually limited to a year at most. Not surprisingly, HAMP modifications stretch out terms by about a year on average.

The inability to stretch out terms for more than a year in most cases has a serious impact on HAMP modifications. The inability to do meaningful term extensions likely means that some homeowners who could afford mortgages if longer term extensions were available are unable to qualify for HAMP modifications. For further discussion of PSAs, see Section C.

5. Servicer Incentives

HAMP provides financial incentives to mortgage servicers, borrowers and investors to modify residential mortgages. Under the first lien program, servicers receive an up-front fee of $1,000 for each completed modification. Second, servicers receive "Pay-for-Success" fees of up to $1,000 each year for up to three years. These fees will be paid monthly and are predicated on the borrower staying current on the loan. Borrowers are eligible for "Pay-for-Performance Success Payments" of up to $1,000 each year for up to five years, as long as they stay current on their mortgage. This payment is applied directly to the principal of their mortgage. The "Responsible Modification Incentive Payment" is a one-time bonus payment of $1,500 to the lender/investor and $500 to servicers that will be awarded for modifications on loans that are still performing. These incentive payments are in addition to the shared cost of reducing the DTI from 38 to 31 percent.

The Second Lien Program also contains a "pay-for-success" structure similar to the first lien modification program. Servicers of junior liens can be paid $500 up-front for a successful modification and then receive successive payments of $250 per year for three years, provided that the modified first loan remains current.[74] If borrowers remain current on their modified first loan, they can receive payments of up to $250 per year for as many as five years.[75] This means that borrowers could receive as much as $1,250 for making payments on time. These borrower incentives would be directed at paying down the principal on the first mortgage.[76] These incentive payments are in addition to the cost sharing available for modifying a second lien or the lump sum payment available for extinguishing a second lien.

Under the Home Price Decline Protection Program (HPDP), investors may be eligible for incentive payments when the value of mortgages that they have modified declines. The incentive payments are calculated based on a Treasury formula incorporating an estimate of the projected home price decline over the next year based on changes in average local market home prices over the two previous quarters, the unpaid principal balance of the mortgage loan prior to HAMP modification, and the mark-to-market loan-to-value ratio of the mortgage loan prior to HAMP modification.[77] In-

[74] MHAP Update, *supra* note 69, at 3; *Introduction of the Second Lien Modification Program (2MP)* (Aug. 13, 2009) (online at www.hmpadmin.com/portal/docs/second__lien/sd0905.pdf) (hereinafter "SLMP Supplemental Directive").

[75] MHAP Update, *supra* note 69, at 3; *Id.*

[76] MHAP Update, *supra* note 69, at 3; *Id.*

[77] U.S. Department of the Treasury, Supplemental Directive 09–04, *Home Affordable Modification Program—Home Price Decline Protection Incentives* (July 31, 2009) (online at www.financialstability.gov/docs/press/SupplementalDirective7–31–09.pdf) (hereinafter "HAMP Supplemental Directive").

centives are to be paid on the first- and second-year anniversaries of the borrower's first trial payment due date under HAMP.[78]

The Foreclosure Alternatives Program facilitates both short sales and deeds-in-lieu by providing incentive payments to borrowers, junior-lien holders, and servicers, similar in structure and amount to HAMP incentive payments. Servicers can receive incentive compensation of up to $1,000 for each successful completion of a short sale or deed-in-lieu.[79] Borrowers are eligible for a payment of $1,500 in relocation expenses in order to effectuate short sales and deeds-in-lieu of foreclosure.[80] The Short Sale Agreement, upon the servicer's option, may also include a condition that the borrower agrees to "deed the property to the servicer in exchange for a release from the debt if the property does not sell the time specified in the Agreement or any extension thereof."[81] In such cases, the borrower agrees to vacate the property within 30 days and, upon performance, receives $1,500 from Treasury to assist with relocation costs.[82] Treasury has also agreed to share the cost of paying junior lien holders to release their claims by matching $1 for every $2 paid by investors, for a maximum total Treasury contribution of $1,000.[83] Payments are made upon the successful completion of a short sale or deed-in-lieu. Although the HOPE for Homeowners program is an FHA program rather than a Treasury program, The Helping Families Save Their Homes Act added incentive payments to servicers, funded through HAMP.[84] These incentive payments closely approximate MHA incentive payments.[85]

It is not yet clear whether these incentive payments are sufficient to overcome the ramp-up costs for servicers to adapt their business models, including hiring and training new employees and creating new infrastructure, as well as other possible incentives not to modify mortgages. For further discussion of servicer incentives, see Section C.

6. Homeowner Outreach

One key to maximizing the impact of a foreclosure mitigation program is putting financially distressed homeowners in contact with someone who can modify their mortgages.[86] Treasury has made significant progress in this area. Treasury's efforts include launching a website (www.MakingHomeAffordable.gov), establishing a call center for borrowers to reach HUD-approved housing counselors, and holding foreclosure prevention workshops and

[78] U.S. Department of the Treasury, *Secretaries Geithner, Donovan Announce new Details of Making Home Affordable Program, Highlight Implementation Progress* (May 14, 2009) (online at www.treas.gov/press/releases/tg131.htm) (hereinafter "Secretaries Geithner, Donovan Announcement").

[79] U.S. Department of the Treasury, *Making Home Affordable: Update: Foreclosure Alternatives and Home Price Decline Protection Incentives* (May 14, 2009) (online at www.treas.gov/press/releases/docs/05142009FactSheet-MakingHomesAffordable.pdf). (hereinafter "MHA May Update").

[80] *Id.*; U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description,* at 5–6 (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing__fact__sheet.pdf) (hereinafter "MHA March Update").

[81] *Id.*

[82] *Id.* This amount is in addition to any funds the servicer may provide to the borrower.

[83] *Id.*

[84] Pub. L. No. 111–22, § 202(b).

[85] Pub. L. No. 111–22, § 202(a)(11).

[86] COP March Oversight Report, *supra* note 21.

counselor training forums in cities with high foreclosure rates.[87] From early May to late August, web hits on Treasury's MHA website doubled from 17 million to 34 million. Self-assessment tools to determine eligibility for the programs under MHA are the foundation of the website. Additionally, other resources on the website, such as the "Look Up Your Loan" tool, which allows a borrower to see if their mortgage is owned by Fannie Mae or Freddie Mac, serve as important resources in navigating the process. The website also offers numerous outlets for borrower education and homeowner outreach. At the Panel's foreclosure mitigation field hearing, Seth Wheeler, senior advisor at the Treasury Department also highlighted the continuing efforts to enhance the capabilities of the HOPE Hotline, the informational call center, to meet the needs of the escalating number of borrowers participating in MHA programs.[88]

Lenders and servicers have also undertaken a campaign to contact distressed borrowers, as well as those whose loans are at risk of default. To date, 1,883,108 letter requests for financial information have been sent to borrowers.[89] While this number still falls far short of Treasury's announced availability to three to four million borrowers, considerable progress can be measured and observed in the first few months of MHA's operation.

Outreach to homeowners must be considered not just in terms of quantity, but also in terms of quality. Servicers must provide effective outreach. Outreach should include more than robo-calls and form letters, and should be provided in plain language that is accessible to all borrowers. Borrowers in financial distress are likely overwhelmed and intimidated, and might not be eager to pay close attention to the entreaties of their creditors. Partnership with community groups and borrower counseling groups is an important element of effective outreach.

Another important consideration in Treasury's outreach strategy involves the role that well-publicized cases of mortgage modification fraud have had in discouraging homeowners from participating in MHA.[90] Although lenders and servicers have sent nearly 1.9 million request letters to distressed borrowers (as mentioned above), it is not clear how many leery recipients avoided opening these letters, or overlooked such responsible letters in the deluge of other fraudulent offers and notices. In a recent study by the Federal Trade Commission (FTC) of online and print advertising for mortgage foreclosure rescue operations, approximately 71 different companies were found to be running suspicious ads.[91] To combat these scams and alleviate concerns for skeptical homeowners, the Admin-

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[87] House Financial Services Committee, Subcommittee on Housing and Community Opportunity, Testimony of U.S. Department of Treasury Assistant Secretary for Financial Institutions Michael S. Barr, *Hearing on Stabilizing the Housing Market* (Sept. 9, 2009) (online at www.makinghomeaffordable.gov/pr__09092009.html) (hereinafter "Barr Hearing Testimony").

[88] Congressional Oversight Panel, Written Testimony of U.S. Department of Treasury Senior Advisor Seth Wheeler, *Philadelphia Field Hearing on Mortgage Foreclosures,* at 8 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony–092409–wheeler.pdf) (hereinafter "Wheeler Philadelphia Hearing Testimony").

[89] HAMP statistics provided by Treasury to the Panel.

[90] Congressional Oversight Panel, *Coping With the Foreclosure Crisis: State and Local Efforts to Combat Foreclosures in Prince George's County, Maryland* (Feb. 27, 2009) (S. Hrg. 111–10).

[91] U.S. Department of the Treasury, *Federal, State Partners Announce Multi-Agency Crackdown Targeting Foreclosure Rescue Scams, Loan Modification Fraud* (Apr. 6, 2009) (online at makinghomeaffordable.gov/pr__040609.html).

istration has started a coordinated multi-agency and federal/state effort, which includes the Department of the Treasury, the Department of Justice, the Department of Housing and Urban Development, the Federal Trade Commission, and state Attorneys General to coordinate investigative efforts, alert financial institutions and consumers to emerging schemes, and enhance enforcement actions.[92] Seth Wheeler said in written testimony to the Panel in September that the federal government has "put scammers on notice that we will not stand by while they prey on homeowners seeking help under our program."[93] These efforts must continue.

Treasury could also consider taking the additional step of sending request letters to homeowners directly from either the Treasury Secretary or the President in order to bring further clarity and authenticity to the process.

7. Scaled Up Quickly

MHA was announced in February 2009, but the program's details were not available until March 2009, and the first trial HAMP modifications did not begin until April 2009. As a result, there were no permanent HAMP modifications until July 2009. In any event, the scale up period should now be over.

The ability of Treasury and servicers to meet demand adequately for the program is likely to have an effect on the overall borrower perception of the program, which could in turn impact the program's effectiveness in future outreach to homeowners. Borrowers will not want to seek assistance from the program if they view it as ineffective or unresponsive. Therefore, the success of borrower outreach is closely linked to servicer capacity and the ability to scale up quickly. Treasury's efforts to press ahead with massive borrower outreach without first addressing servicer capacity issues could hurt the public perception and credibility of the program.

In response to a question from the Panel on this point, Treasury Assistant for Financial Stability Secretary Herbert Allison indicated that Treasury Secretary Timothy Geithner and Housing and Urban Development Secretary Shaun Donovan have "called on servicers to take specific steps to increase capacity, including adding more staff than previously planned, expanding call centers beyond their current size, providing an escalation path for borrowers dissatisfied with the service they have received, bolstering training of representatives, developing extra on-line tools, and sending additional mailings to borrowers who may be eligible for the program."[94] It is critical that the efforts to increase capacity keep pace with the efforts to reach out to borrowers.

8. Widespread Participation

Widespread servicer participation is an essential part of a successful foreclosure mitigation program. Servicers of Fannie Mae

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[92] Participants include: Treasury, the U.S. Department of Justice (DOJ), HUD, FTC, and the Attorney General of Illinois. *Id.*

[93] Wheeler Philadelphia Hearing Testimony, *supra* note 88.

[94] Congressional Oversight Panel, Questions for U.S. Department of the Treasury Assistant Secretary for Financial Stability and Counselor to the Secretary, Herb Allison, at 7 (June 24, 2009) (hereinafter "Allison COP Testimony").

and Freddie Mac mortgages are required to participate in HARP, covering approximately 2,300 servicers.[95]

HAMP has both a voluntary and mandatory participation component for lenders/servicers. Any participants in TARP programs initiated after February 2, 2009, are required to take part in mortgage modification programs consistent with Treasury standards.[96] Since the Capital Purchase Program (CPP), the primary TARP vehicle for bank assistance, was established prior to this date, the majority of financial institutions are not obliged to participate. However, servicers of Fannie Mae or Freddie Mac mortgages are obligated to participate in HAMP for their Fannie Mae and Freddie Mac mortgages.

On the voluntary servicer participation side, Treasury estimates that 85 percent of HAMP-eligible mortgage debt is serviced by participating servicers.[97] This comes close to Treasury's projection that HAMP will ultimately cover 90 percent of the potential loan population.[98] Through October 6, 2009, 63 servicers are participating in the program.

The Second Lien Program is not yet operational. According to testimony by Assistant Secretary Allison, Treasury is currently negotiating participation contracts with servicers covering more than 80 percent of the second lien market. For further discussion of servicer participation issues, see Section C.

9. Recommendation on Data

In its March 2009 Report, the Panel noted a distressingly poor state of knowledge among federal regulatory agencies about the mortgage market, that constituted a full-blown regulatory intelligence failure. In particular, the Panel was concerned about the federal government's limited knowledge regarding loan performance and loss mitigation efforts and foreclosure. These failures of financial intelligence collection and analysis have only been partially remedied; major gaps in coverage still exist.

Treasury's major advance in this area has been to start collecting a range of data on HAMP modifications, both those in trial periods and those made permanent. The data permit examination of the characteristics of the borrowers and property, the terms of the modification, the servicer involved, and payments to the servicer. The development of a robust database on HAMP modifications is an important step forward in addressing the foreclosure crisis.

There are important limitations to these new data. Unlike HAMP, other MHA programs collect much more limited data. There are also two notable gaps in the HAMP modification data. First, the data exist only on loans for which a trial modification has commenced. As a result, the Panel lacks data on loans for which trial modifications have been denied, much less the performance of

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[95] U.S. Department of the Treasury, *Making Home Affordable Program, Servicer Performance Report through August 2009* (Oct. 8, 2009) (online at www.treas.gov/press/releases/docs/MHA%20Public%20100809%20Final.pdf) (hereinafter "Servicer Performance Report").

[96] U.S. Department of the Treasury, *Fact Sheet Financial Stability Plan* (February 9, 2009) (online at www.financialstability.gov/docs/fact-sheet.pdf) (hereinafter "Financial Stability Plan Fact Sheet").

[97] Servicer Performance Report, *supra* note 95.

[98] Government Accountability Office, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable,* at 32 (July 2009) (online at www.gao.gov/new.items/d09837.pdf) (hereinafter "GAO HAMP Report").

the entire universe of loans. Further, the Panel lacks data for the programs not yet online, such as the Second Lien Program and Foreclosure Alternatives Program. This information is crucial for understanding the changing nature of the foreclosure crisis and crafting informed, targeted policy responses. Second, the data collected by Treasury are largely limited to HAMP modifications, so it does not allow easy integration with data on other modification programs. OCC/OTS have produced quarterly reports on mortgage modification efforts for 14 of the largest bank/thrift-servicers under their supervision, and this data includes HAMP and non-HAMP modifications, but it covers only 64 percent of the market.

While data collection has improved, further improvement is necessary. Moreover, improved data collection alone is insufficient. While the Panel assumes that Treasury has engaged in its own internal analysis of HAMP data, Treasury has yet to produce any public detailed analysis of the HAMP data. The releases to date have contained only minimal information about the number of modifications and the level of servicer participation. The Panel is hopeful that more informative data releases will be forthcoming on a regular basis. The Panel is also hopeful that Treasury will enable outside parties to have easy access to the data; analysis of such government-produced data by academics and non-profits has helped improve countless government programs in the past, and there is no reason to believe HAMP is different. While the Panel recognizes that there are privacy concerns, the level of personally identifiable data could easily be limited to that found in Home Mortgage Disclosure Act (HMDA) data releases.

In sum, Treasury has made progress on data collection, but because the data covers only loans that have been approved for a specific modification program, essential information about the foreclosure crisis remains unknown. Instead, the government is forced to continue to rely on imperfect private data sources. Better consumer finance intelligence gathering and analysis remains a critical gap in formulating policy responses.[99]

This is not the first instance in which the need for such data has been acknowledged. In response to the savings and loan crisis in the 1980s, Congress directed the Department of Housing and Urban Development (HUD) to produce national mortgage default and foreclosure reports.[100] It appears that HUD never produced any such reports, and Congress eliminated the reporting requirement, along with many other agency reporting requirements in

[99] Deborah Goldberg, director of the Hurricane Relief Project at the National Fair Housing Alliance, made a similar point in her testimony during the Panel's hearing on mortgage foreclosures in Philadelphia in September. Congressional Oversight Panel, Testimony of Director of the National Fair Housing Alliance's Hurricane Relief Project, Deborah Goldberg, *Philadelphia Field Hearing on Mortgage Foreclosures,* at 78 (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing–092409–philadelphia.cfm) (hereinafter "Goldberg Philadelphia Hearing Testimony"). Ms. Goldberg urged improvements in "data that are collected and made public about how servicers are performing under the program" and noted that her organization "think[s] it's very critical that loan level data, including information on the race, gender, and national origin of the borrower who's applying for the HAMP modification be made available to the public and that [sic] be done at a geographic level that makes it possible for public officials, community organizations, individual borrowers, and the public at large to understand how the program is working in their communities, to be able to identify places where it may not be working equitably or efficiently and to be able to intervene to change that." *Id.*

[100] 12 U.S.C. 1701p–1 (1983).

1995.[101] Data collection has improved, but is still lacking in critical respects.

Panel's March checklist	Progress of MHA after six months
Will the plan result in modifications that create affordable monthly payments?.	Significant progress; some areas not addressed, including unemployment-related foreclosures
Does the plan deal with negative equity?	Not addressed in a substantial way
Does the plan address junior mortgages?	Unclear—program announced but not yet running
Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?.	Unclear
Does the plan counteract mortgage servicer incentives not to engage in modifications?.	Unclear—incentive structures included, but payments just beginning
Does the plan provide adequate outreach to homeowners?	Significant progress; more needed
Can the plan be scaled up quickly to deal with millions of mortgages?.	Some progress; more needed
Will the plan have widespread participation by lenders and servicers?.	Significant progress
Is data collection sufficient to ensure the smooth and efficient functioning of the mortgage market and prevent future crisis?.	Significant progress; more needed

C. Program Evaluation

MHA represents Treasury's primary foreclosure mitigation effort. MHA's main programs are HARP and HAMP. HAMP includes the Second Lien Program, the Home Price Decline Protection Program (HPDP), and the Foreclosure Alternatives Program (FAP). Treasury estimates that assistance under HARP and HAMP will be offered to as many as seven to nine million homeowners.[102] Treasury has designed each program and subprogram to help in that effort, and in announcing each initiative outlined the specific ways in which it would help prevent foreclosures. In evaluating the programs, this section considers the goals articulated by Treasury, the programs' design, the results achieved to date in light of the relatively early stages of most programs, and whether or not the programs are well designed to meet the stated objectives. Adequacy of the goals is considered separately in the subsequent section.

[101] Federal Reports Elimination and Sunset Act of 1995 § 3003, Pub. L. No. 104–66.
[102] U.S. Department of the Treasury, *Making Home Affordable Summary of Guidelines* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/guidelines_summary.pdf) (hereinafter "MHA Summary Guidelines").

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	362,348 unique 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*	*362,348 unique 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*

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

1. HARP

HARP was announced on March 4, 2009, and permits homeowners with current, owner-occupied, government sponsored enterprise (GSE)-guaranteed mortgages to refinance into a GSE-eligible mortgage.[103] The program does not utilize TARP funding. At its core, HARP is aimed at providing low-cost refinancing to homeowners who have been negatively affected by the decline in home values. Unlike other portions of MHA, HARP is not directed toward homeowners who are behind on their mortgage payments. Instead, the program is intended for homeowners who are current on their mortgage payments, have not been delinquent by more than thirty days within the previous year and are not struggling to make their monthly payments.[104] Assistant Secretary Allison explained that the program "helps homeowners who are unable to benefit from the low interest rates available today because price declines have left them with insufficient equity in their homes."[105] Treasury estimates that HARP could assist between four to five million homeowners who would otherwise be unable to refinance because their homes have lost value, pushing their current loan-to-value ratios above 80 percent.[106]

Other than the requirement that the borrower is current on monthly mortgage payments, the program has relatively few restrictive requirements. All mortgages that are owned or guaranteed by either Fannie Mae or Freddie Mac may participate in HARP.[107] Existing jumbo-conforming and high-balance loans may qualify for the program, in part because of higher temporary loan limits. However, there is not a cash-out component to the HARP refinance and as such, subordinated financing may not be paid with the proceeds from the refinancing. Finally, Treasury promotes the relative ease of this program since participants' records are centralized with either Fannie Mae or Freddie Mac; as such, documentation requirements should be less onerous than other comparable programs.[108]

Servicers of Fannie Mae and Freddie Mac mortgages are required to participate in the program, covering approximately 2,300 servicers.[109]

Initially, borrowers were eligible to refinance if they owed up to 105 percent of the present value of their single-family residence. In response to the continued decline of home values, on July 1, 2009, Treasury announced an expansion of the program that included borrowers who owe up to 125 percent of the value of their homes. This expands the universe of homeowners potentially eligible for

[103] MHA Summary Guidelines, *supra* note 102.

[104] Fannie Mae, *Home Affordable Refinance FAQs*, at 4 (July 24, 2009) (online at www.efanniemae.com/sf/mha/mharefi/pdf/refinancefaqs.pdf) (hereinafter "Fannie Mae FAQs").

[105] Senate Banking, Housing and Urban Affairs Committee, Testimony of U.S. Department of Treasury Assistant Secretary Herb Allison, *Preserving Homeownership: Progress Needed to Prevent Foreclosures*, 111th Cong. (July 16, 2009) (hereinafter "Allison Senate Testimony").

[106] U.S. Department of the Treasury, *Making Home Affordable Summary of Guidelines* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/guidelines__summary.pdf). HARP is not limited to above 80 percent LTV refinancings. It is unclear, however, what would distinguish a HARP refinancing from a regular GSE refinancing if the LTV were under 80 percent. Therefore, the Panel is only counting GSE refinancings with LTV over 80 percent as HARP refinancings. The Panel emphasizes that regular course GSE refinancings are not counted as part of HARP in this report.

[107] MHA Summary Guidelines, *supra* note 102.

[108] Servicer Performance Report, *supra* note 95.

[109] Servicer Performance Report, *supra* note 95.

refinancing, and means that HARP could, in theory, assist more than the four to five million homeowners originally estimated. Fannie Mae and Freddie Mac will begin accepting deliveries of these refinanced loans on September 1 and October 1, respectively. Generally, the GSEs are prohibited from purchasing mortgages with loan-to-value (LTV) ratios above 80 percent unless there was private mortgage insurance coverage on the loan. HARP refinancings do not require the borrower to obtain additional private mortgage insurance coverage. If there was no coverage on the original loan, coverage is not required, and if there was coverage on the original loan, additional coverage is not required.

There are two distinct borrower benefit requirements under HARP; the refinancing needs to satisfy only one of them to qualify. The first states that the requirement is met if the borrower's mortgage payment is decreased. In this circumstance, it is acceptable for the borrower to extend the term of the loan or change the mortgage from a fixed-rate loan to an adjustable-rate. The second borrower benefit standard states that if the homeowner's monthly payment remains flat, or increases, then the borrower must be moving to "a more stable mortgage product." [110] Under the program guidelines, a transition out of interest-only and adjustable-rate mortgages would qualify as comparatively stable. Also, a shift to a shorter-term loan that would accelerate the amortization of equity would qualify. The borrower may not extend the term of the loan or switch to an ARM from a fixed-rate in order to be compliant under the second borrower benefit requirement.

HARP refinancings permit eligible borrowers to refinance their mortgages despite negative equity. HARP does not dictate the terms of the refinanced mortgage other than prohibiting prepayment penalties and balloon payments. A refinanced mortgage could thus be fixed or adjustable rate, and at any interest rate. HARP refinancings aim for both affordability and sustainability, but sometimes the two goals will be at loggerheads. For example, borrowers with non-traditional mortgages that had introductory periods with low monthly payments, such as hybrid ARMs, interest-only mortgages, and payment-option ARMs, might refinance into fixed-rate, fully-amortizing mortgages. The shift from a non-traditional mortgage to a traditional fixed-rate mortgage may result in an increase in the borrower's monthly payments, but it will improve the long-term sustainability of the loan. The assumption underlying HARP is that homeowners will refinance if they believe it makes their mortgage more affordable.

Treasury was unable to provide the Panel with complete data on HARP refinancing applications. Application data was only available for one GSE. The only complete data available was on the total number of closed approved refinancings. 95,729 refinancings have been approved as of September 1, 2009. HARP has thus covered only 2 percent of the four to five million homeowners Treasury originally estimated would be eligible when the program was limited to loans with less than 105 percent LTV ratios. Moreover, for the one GSE for which Treasury provided data, HARP refinancing

[110] Fannie Mae FAQs, *supra* note 104.

applications have fallen every month since May 2009.[111] It is not clear why there have been relatively few HARP refinancings; beyond HARP's eligibility requirements, one concern is that liquidity-constrained homeowners are unable to afford points and closing costs on the refinancings.

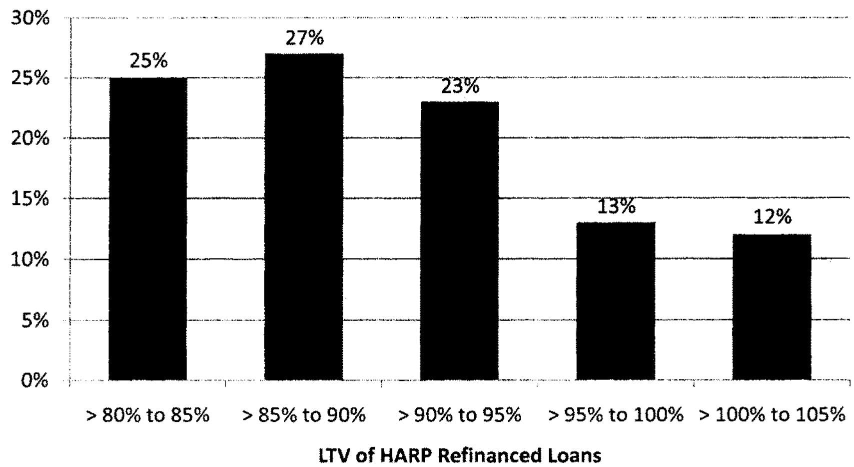
If HARP ultimately reaches Treasury's stated availability of four to five million borrower refinancings it will have a sizeable impact on the foreclosure problem. Moreover, if housing prices increase then more borrowers with higher levels of negative equity will come within HARP's expanded LTV limit and thereby become eligible for HARP refinancing to lower more affordable rates and safer products.

The decline in applications, however, coupled with the low total number of refinancings raises serious doubts about whether HARP will ever come close to assisting a significant percentage of the four to five million homeowners. Moreover, if interest rates go up during the duration of the HARP program, as will likely happen should housing prices stabilize, HARP refinancings will become relatively less appealing to many eligible homeowners.

It is important to emphasize that although HARP allows underwater homeowners to refinance to a more affordable and/or sustainable loan despite negative equity, HARP does not cure negative equity; instead, it is focused on removing negative equity as an obstacle to improving affordability, permitting a homeowner with negative equity to continue to make payments. The majority of HARP refinancings, however, are loans with less than 90 percent LTV ratios. (See Figure 13.) For these loans, LTV ratios would not normally be an obstacle to refinancing. Therefore, the only reason these loans should have been refinanced through HARP, rather than through private channels, would have been if refinancing were impeded by other factors, such as curtailed income. Thus, while HARP underwriting standards allow not only for higher LTV refinancings without additional private mortgage insurance (PMI) coverage, they might also permit refinancings with reduced income levels.

[111] It is not clear why HARP refinancing application data is unavailable for the other GSE. In response to Panel requests, Treasury provided a broad range of data related to the mortgage market. Although not all of the data are confidential, portions are. These data are cited in numerous places throughout the report, and are hereinafter cited as "Treasury Mortgage Market Data."

Figure 13: HARP Refinancings by LTV[112]



2. HAMP

HAMP, also announced on March 4, 2009, is another sub-program of MHA. HAMP is funded by a government commitment of $75 billion, which is comprised of $50 billion of TARP funds and $25 billion from the Housing and Economic Recovery Act (HERA). The $50 billion of TARP funds is directed toward modifying private-label mortgages, and the $25 billion from the Housing and Economic Recovery Act is dedicated to the modification of Fannie Mae and Freddie Mac mortgages. Treasury has estimated that HAMP will help three to four million homeowners.[113] The goal of HAMP is to create a partnership between the government and private institutions in order to reduce borrowers' gross monthly payments to an affordable level. The level has been set at 31 percent of the borrower's gross monthly income. Lenders are expected to reduce payments to 38 percent of the borrower's monthly income. The government and the private lender then share the burden equally of reducing the borrower's monthly payment to 31 percent of his or her gross monthly income. In addition to providing monetary incentives for the modification of at-risk mortgages, HAMP standardizes loan modification guidelines in order to create an industry paradigm.

a. Lender and Servicer Participation

HAMP has both a voluntary and mandatory participation component for lenders/servicers. On February 9, 2009, the Administration announced that as part of its Financial Stability Plan, any participants in TARP programs initiated after that date would be required to take part in mortgage modification programs consistent

[112] Treasury Mortgage Market Data, *supra* note 111.

[113] GAO has questioned whether these estimations may be overly optimistic due to key assumptions, such as borrower response rate and participation rate. GAO HAMP Report, *supra* note 98.

with Treasury standards.[114] Since the Capital Purchase Program (CPP), the primary TARP vehicle for bank assistance, was established prior to the Financial Stability Plan, the majority of financial institutions are not obligated to participate. However, servicers of Fannie Mae or Freddie Mac mortgages are obligated to participate in HAMP for their Fannie Mae or Freddie Mac mortgages.

On the voluntary servicer participation side, Treasury estimates that 85 percent of HAMP-eligible mortgage debt is serviced by participating servicers.[115] This comes close to Treasury's projection that HAMP will ultimately cover 90 percent of the potential loan population.[116] Servicer participation in HAMP, however, is voluntary.[117] Through October 6, 2009, 63 servicers have signed servicer participation agreements for HAMP.[118] Servicers begin the participation process by completing a registration form, and ultimately sign a Servicer Participation Agreement with Fannie Mae.[119] Treasury, through Fannie Mae, is reaching out to servicers with large numbers of eligible loans that have not yet signed up with the program.[120]

HAMP provides financial incentives to mortgage servicers, borrowers and investors to modify residential mortgages. First, servicers receive an up-front fee of $1,000 for each completed modification for up to three years. Second, servicers receive "Pay-for-Success" fees of up to $1,000 each year for up to three years. These fees will be paid monthly and are predicated on the borrower staying current on the loan. Borrowers are eligible for "Pay-for-Performance Success Payments" of up to $1,000 each year for up to five years, as long as they stay current on their payment. This payment is applied directly to the principal of their mortgage. The "Responsible Modification Incentive Payment" is a one-time bonus payment of $1,500 to the lender/investor and $500 to servicers that will be awarded for modifications on loans that are still performing. Finally, Treasury estimates that up to 50 percent of at-risk mortgages have second liens.[121] In order to address second lien debts, such as home equity lines of credit or second mortgages, HAMP encourages servicers to contact second lien holders and negotiate the

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[114] Financial Stability Plan Fact Sheet, *supra* note 96.

[115] Servicer Performance Report, *supra* note 95.

[116] GAO HAMP Report, *supra* note 98, at 32. Citing an analysis of unnamed OFS documents that the Panel has been unable to recover as of the release of this report.

[117] As discussed in section B5, *infra,* servicers receive incentives to participate. Servicers have until December 31, 2009 to opt in to the program. U.S. Department of Treasury, *Borrower Frequently Asked Questions* (July 16, 2009) (online at makinghomeaffordable.gov/borrower-faqs.html).

[118] Servicer Performance Report, *supra* note 95.

[119] Treasury has designated Fannie Mae as its financial agent in connection with HAMP. Making Home Affordable Administrative Website for Servicers, *Commitment to Purchase Financial Instrument and Servicer Participation Agreement,* at 1 (online at www.hmpadmin.com/portal/docs/hamp__servicer/servicerparticipationagreement.pdf) (accessed Oct. 7, 2009).

[120] Treasury explained that:

> Efforts include one-on-one meetings and presentations during which Fannie Mae personnel outline the program benefits, as well as requirements. Subsequent to the introductory meeting, members of the Fannie Mae HAMP team are assigned to serve as points of contact for prospective servicers, providing more detailed information, answering questions, and keeping in touch on a regular basis. We expect that this approach will result in the addition of more servicers to the program in the coming days and weeks. Fannie Mae also provides program training and tools designed to make servicer implementation as efficient as possible. Since the HAMP was announced, more than 300 servicers have downloaded packages from the Fannie Mae website. Fannie Mae will continue to actively solicit additional servicers for participation in order to maximize program impact.

Allison COP Testimony, *supra* note 94.

[121] MHAP Update, *supra* note 69.

extinguishment of the second lien. The servicers will receive a payment of $500 per second lien modification, as well as success payments of $250 per year for three years, as long as the modified first loan remains current. Borrowers also receive success payments for participating of $250 per year for up to five years that is used to pay down the principal on the first lien.

b. Borrower Eligibility

HAMP modifications begin with a three month trial modification period for eligible borrowers. After three months of successful payments at the modified rate and provision of full supporting documentation, the modification becomes permanent.[122] To be eligible to participate in HAMP, the loan must have been originated on or prior to January 1, 2009, and the mortgage must be a first lien on an owner-occupied property with an unpaid balance up to $729,750.[123] The loan must be in default or in imminent danger of default.[124] Borrowers in bankruptcy or in active litigation regarding their mortgage can participate in the program without waiving their legal rights.

Under the first lien program, the homeowner must certify a hardship causing the default. If the borrower has a back-end DTI ratio of 55 percent or more—meaning that the borrower's total monthly debt payments, including credit cards and other forms of debt, are at least 55 percent of monthly income—he or she must enter a debt counseling program.[125]

A Net Present Value (NPV) test is required for each loan that is in "imminent default" or is at least 60 days delinquent. First, servicers determine the NPV of the proceeds from the liquidation and sale of a mortgaged property. Variables to take into account are:

1. The current market value of the property as established by a broker's price opinion, automated valuation methodology, or appraisal;
2. The cost of foreclosure proceedings, repair and maintenance of the property;
3. The time to dispose of the property if not sold at foreclosure auction;

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[122] Treasury permits servicers to do so-called "verbal" or "no-doc" trial modifications. In these verbal modifications, the servicer halts foreclosure actions and allows the borrower to make reduced payments based on the borrower's unverified representations about income and debt levels. Each servicer chooses the level of documentation required to commence a trial modification, but for the modification to become permanent and the servicer to receive compensation from Treasury, full documentation is required. While doing no-doc trial modifications brings more borrowers into HAMP more quickly and freezes the foreclosure process, it might have a detrimental effect on producing permanent HAMP modifications. Congressional Oversight Panel, Testimony of Freddie Mac Senior Vice President for Economics and Policy, Edward L. Golding, *Philadelphia Field Hearing on Mortgage Foreclosures,* at 29 (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm).

[123] The unpaid balance ceiling increases in relation to number of units on the property (2 units—$934,200; 3 units—$1,129,250; 4 units—$1,403,400). The effect of this limitation is most pronounced in high-cost areas, although recent changes to raise the conforming loan limit in certain high-cost areas have made more loans potentially eligible for HAMP modifications in these areas.

[124] At the field hearing, Larry Litton cited servicers' need for greater clarity around the definition of imminent default. Congressional Oversight Panel, Testimony of Litton Loan Servicing President and CEO, Larry Litton, *Philadelphia Field Hearing on Mortgage Foreclosures,* at 144–45 (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm).

[125] However, as noted by GAO, there is no mechanism to ensure that housing counseling happens, and Treasury does not plan to track borrowers systematically who are told that they must get counseling. GAO HAMP Report, *supra* note 98.

4. Costs associated with the marketing and sale of the property as real estate owned; and
5. The net sales proceeds.[126]

Second, servicers determine the proceeds from a loan modification. Treasury has established parameters for running the NPV for modification test. The servicer may choose the discount rate for the calculation although there is a ceiling set by the Freddie Mac Primary Mortgage Market Survey rate (PMMS), plus a spread of 2.5 percentage points. The servicer may apply different discount rates to loans in investor pools versus loans in portfolio. Cure rates and redefault rates must be based on GSE analytics. Servicers having at least a $40 billion servicing book have the option to substitute GSE-established cure rates and redefault rates with the experience of their own aggregate portfolios.

The NPV of the foreclosure scenario is then compared to an NPV for a modification scenario. If the NPV of the modification scenario is greater, then the servicer must offer to modify the loan.

Prior to September 1, 2009, servicers were permitted to use either their own NPV calculation method or a standardized model created by Treasury. Since September 1, 2009, all servicers are required to use Treasury's standard NPV model for HAMP modification purposes. See Annex C for an examination of Treasury's NPV model.

The Panel also notes that the NPV model of other government entities, such as the OCC, the OTS, and the FDIC for Indy Mac, assumes an average redefault rate of 40 percent, but Treasury would need to factor in significant variation depending on income, FICO, and LTV. Changes in assumed redefault rates (which may themselves be functions of the type of modification involved) will obviously affect the NPV calculus. The inputs for Treasury's NPV model are not public, in part because of concerns that borrowers might be able to game the calculation. Unfortunately, the secrecy of Treasury's NPV model means that it is not subject to robust scrutiny. The public unavailability of the NPV model also means that homeowners are unable to verify whether they have been appropriately denied a modification. Housing counselors frequently attempt to negotiate loan modifications based on having run an NPV comparison that they then present to the loan servicer. Making the model publicly available would facilitate negotiations and provide an important check against wrongful modification denials. A possible solution is to make the NPV calculator publicly available as a web application, which would limit the ability to engage in a systematic deconstruction of the model for purposes of gaming it.

c. Lender Procedures

The front-end DTI target is 31 percent. The lender will first have to reduce the borrower's mortgage payments to no greater than 38 percent front-end DTI ratio. Treasury will then match the investor/lender dollar-for-dollar in any further reductions, down to a 31 percent front-end DTI ratio for the borrower. Treasury has established a 2 percent floor below which it will not subsidize interest rates.

[126] Jordan D. Dorchuck, *Net Present Value Analysis and Loan Modifications* (Sept. 15, 2008) (online at www.mortgagebankers.org/files/Conferences/2008/RegulatoryComplianceConference08/RC08SEPT24ServicingJordanDorchuck.pdf).

Lenders and servicers could reduce principal rather than interest at any stage in the waterfall and would receive the same funds available for an interest rate reduction.

Servicers follow the "standard waterfall" steps detailed below in order to achieve efficiently the 31 percent front-end DTI ratio:

1a. Request monthly gross income of borrower;

1b. Validate first lien debt and monthly payments. This information is used to calculate a provisional modification for the trial period. A trial modification typically lasts for three months, and then becomes permanent if the borrower has made the required trial payments, and the borrower's debt and income documentation has been submitted and determined to be accurate. Servicers have discretion on whether to start trial modifications only after borrowers have submitted the written documentation, or based on verbal information that borrowers provide over the phone;

2. Capitalize arrearage;

3. Target front-end DTI of 31 percent and follow steps 4, 5, and 6 in order to reduce the borrower's monthly payment;

4. Reduce the interest rate to achieve target (two percent floor). The guidelines specify reductions in increments of 0.125 percent that should bring the monthly payments as close to the target without going below 31 percent. If the modified interest rate is above the interest rate cap as defined by Treasury, then the modified interest rate will remain in effect for the remainder of the loan. If the modified interest rate is below the interest rate cap, it will remain in effect for five years followed by annual increases of one percent until the interest rate reaches the interest rate cap. The modified interest rate will then be in effect for the remainder of the loan;

5. If the front-end DTI target has not been reached, the term or the amortization of the loan may be extended up to 40 years; and

6. If the front-end DTI target has still not been reached, it is recommended that the servicer forbear principal. If there is principal forbearance, then a balloon payment of that amount is due upon the maturity of the loan, the sale of the property, or the payoff of the interest bearing balance.

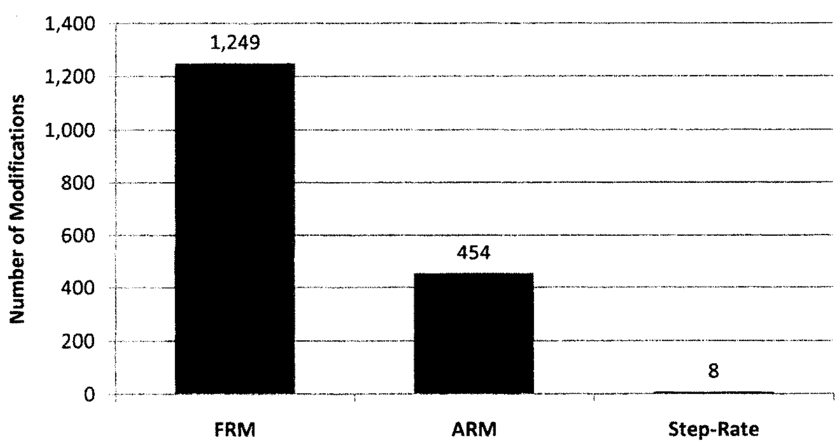
d. HAMP Results to Date

Because the program collects far more data than any other MHA program, HAMP reveals a fuller picture of the results to date. Based on certified data provided by Fannie Mae, Treasury's agent for HAMP, the following statistical picture of HAMP emerges. As of September 1, 2009 there were 1,711 permanent modifications and 362,348 additional unique borrowers were in trial modifications. Only 1.26 percent of HAMP modifications had become permanent after the anticipated three-month trial. The Panel emphasizes that this does not mean that the other 98.74 percent of HAMP trial modifications have failed, merely that they have not yet become permanent. Many borrowers in trial modifications are in the process of submitting documentation, and Treasury has provided additional flexibility in the timeline through a two-month extension. It is also important to remember that this is still a new program in a ramp-up period, and this statistic is preliminary.

The Panel has not been able to determine why there is such a low rate of conversion from trial to permanent modifications. Possibilities identified to date include failure of borrowers to comply with the terms of the trial, including timely payments; the difficulties servicers have in assembling completed documentation on modifications commenced on a "verbal" or "no-doc" basis;[127] delays in servicers submitting data to Treasury; and data quality issues. There is also significant variation by servicer in terms of the percentage of trial modifications that become permanent after three months, an issue discussed below.

As of September 1, 73 percent of the permanent modifications involved fixed-rate mortgages, with adjustable-rate mortgages making up 27 percent and a negligible number of step-rate mortgages. (See Figure 14, below.)

Figure 14: Pre-Modification Loan Type of Completed HAMP Modifications[128]

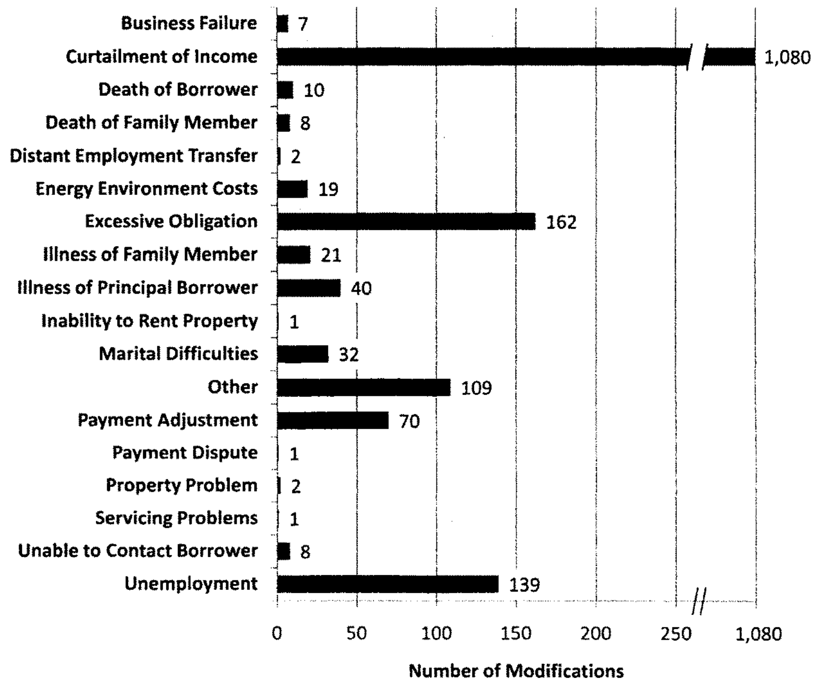


A variety of hardship reasons were given by borrowers when requesting the modifications. By far the most common was "curtailment of income," which was reported by 63 percent of borrowers and reflects reduced employment hours, wages, salaries, commissions, and bonuses. This is distinct from unemployment, reported by eight percent of borrowers. Other significant categories of hardship reported were "excessive obligation," reported by nine percent of borrowers, "payment adjustment," reported by four percent of borrowers, and illness of borrower, reported by two percent of borrowers. Six percent of borrowers reported "other." (See Figure 15, below.) It is notable that curtailment of income is the majority hardship basis, as this implies that general economic conditions, rather than mortgage rate resets on subprime or payment-option or interest-only loans are driving the mortgage crisis at present. Because HAMP eligibility generally requires employment, this raises

[127] Treasury has authorized an additional two-month period for assembly for documentation beyond the 3-month trial period.
[128] Treasury Mortgage Market Data, *supra* note 111.

concerns as to whether HAMP, which was designed in the winter of 2009, is capable of dealing with emerging causes of foreclosure.

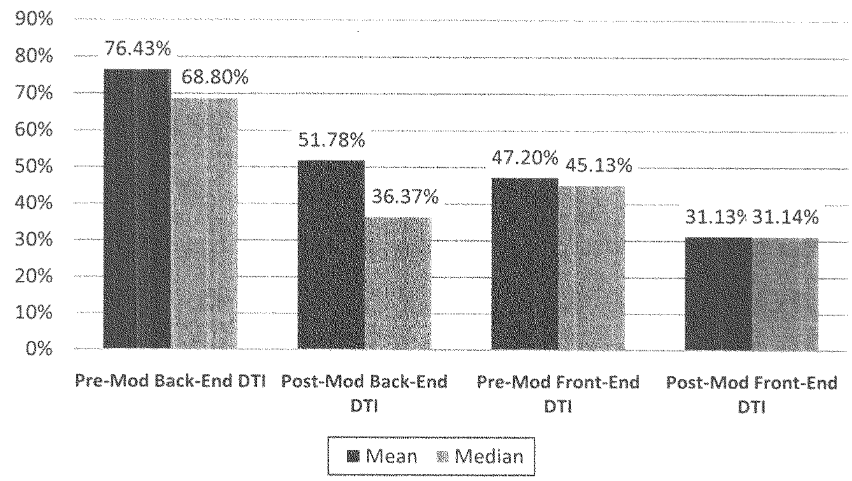
Figure 15: Hardship Reasons for Completed HAMP Modifications[129]



For the modifications that have become official, the median (mean) front-end DTI declined 31 (34) percent, from 45.1 (47.2) percent to 31.1 (31.1) percent, in line with the program's goal. The median (mean) back-end DTI ratio declined 47 (32) percent from 68.8 (76.4) percent to 36.4 (51.8) percent. (See Figure 16, below.)

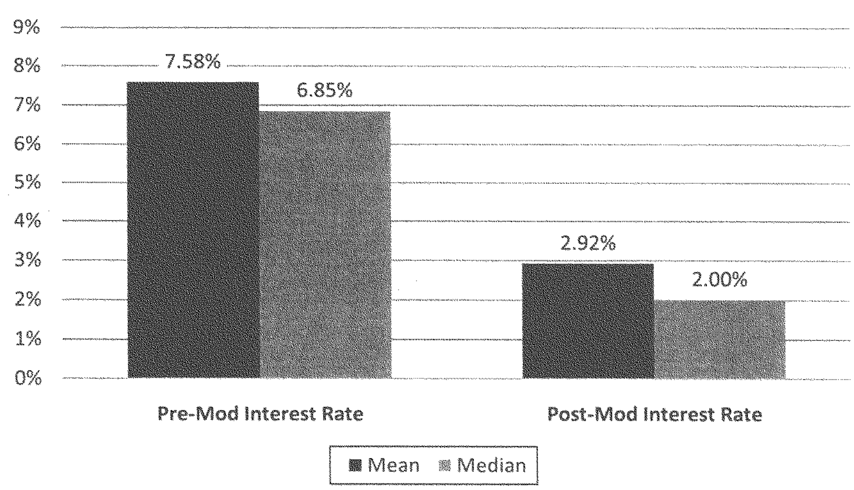
[129] Treasury Mortgage Market Data, *supra* note 111.

Figure 16: Back- and Front-End Debt-to-Income Ratios Pre- and Post-HAMP Modifications[130]



The reduction in DTI in HAMP modifications was achieved almost exclusively through reductions in interest rate, rather than term extensions or principal reductions. Median (mean) interest rates were dropped by 4.25 (4.65) percentage points, from 6.85 (7.58) percent to 2.00 (2.92) percent, a 71 (61) percent reduction in the rate. (See Figure 17, below.)

Figure 17: Interest Rates Pre- and Post-HAMP Modifications[131]



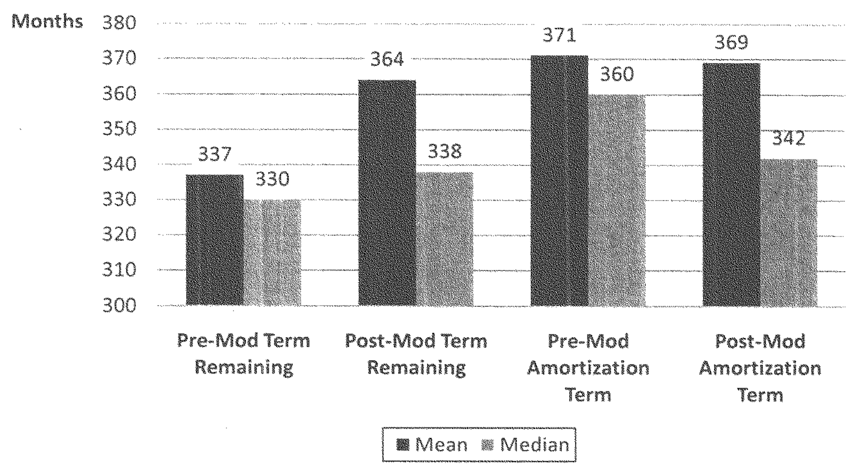
Term extensions were de minimis; the median (mean) term remaining before modification was 330 (337) months, and after a three-month trial period, the median (mean) term remaining was

[130] Treasury Mortgage Market Data, *supra* note 111.
[131] Treasury Mortgage Market Data, *supra* note 111.

338 (364) months, indicating a median (mean) term extension of five months (two years). 989 permanent modifications or 57 percent of total featured term extensions, while 645 or 38 percent of total involved reductions in remaining terms. A portion of the term reductions, however, is attributable to the time lapse between the start of the trial modification and the permanent modification date.

Amortization periods changed relatively little. Before modification, the median (mean) amortization period was 360 (371) months, while post-modification, the amortization period was 342 (369) months. (See Figure 18, below.) The amortization period increased in 618 modifications or 36 percent of the total, while it was decreased in 1013 modifications or 59 percent of total. The Panel is puzzled by the prevalence of both amortization and term decreases.

Figure 18: Term and Amortization Periods for Permanent HAMP Modifications[132]



Principal forbearance was rare and principal forgiveness rarer still. Two hundred sixty-one permanent modifications (15 percent of total) had principal forborne, while only 5 (less than one percent of total) had principal forgiven. When calculated based on all permanent modifications, the median (mean) amount of principal forborne was zero ($9,434.58), and the median (mean) amount of principal forgiven was zero ($170.89). When calculated only for the modifications with principal forbearance, however, the median (mean) amount forborne was $47,367.61 ($61,848.92) or 22 (25) percent of post-modification unpaid principal balance, implying a sizeable balloon payment at the maturity of the mortgage.

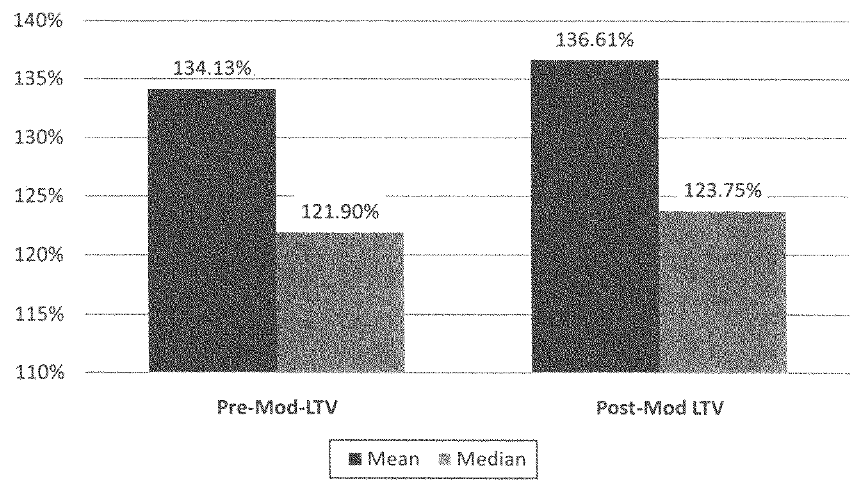
Before modification, the median (mean) LTV was 121 (134) percent. 471 (27 percent) loans had LTV ratios of under 100 percent before modification and 299 (17 percent) had LTV ratios of under 90 percent before modification.[133] Modification increased the median and mean LTV modestly due to capitalization of arrearages and escrow requirements; borrowers' actual obligations did not in-

[132] Treasury Mortgage Market Data, *supra* note 111.

[133] The large number of <90 percent LTV loans in HAMP is likely a function of curtailment of income, as even if the LTV would not make the loan ineligible for refinancing, lack of sufficient income to support the loan would.

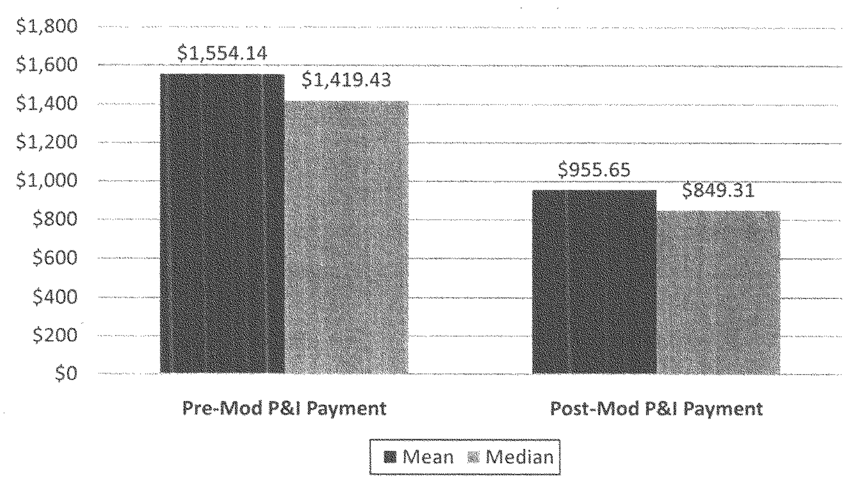
crease as the result of modifications. Thus, post-modification, the median (mean) LTV was 124 (137) percent. Post-modification, 424 were calculated as having under 100 percent LTV and 274 with LTVs under 90 percent. (See Figure 19.)

Figure 19: Loan-to-Value Ratios Pre- and Post-HAMP Modifications[134]



The net result of the modifications was that median (mean) monthly principal and interest payments dropped $500.25 ($598.49), from $1,419.43 ($1,554.14) to $849.31 ($955.65), a 35 (39) percent decline. As Figure 20 shows below, HAMP modifications resulted in a noticeable decrease in monthly principal and interest payments for many borrowers, but generally resulted in minimal changes in principal balances.

Figure 20: Monthly Principal & Interest Payment Pre- and Post-HAMP Modifications[135]



[134] Treasury Mortgage Market Data, *supra* note 111.

e. Meeting Affordability Goal

While the Panel previously questioned whether 31 percent front-end DTI was the appropriate affordability target, a reduction in front-end DTI to 31 percent will undoubtedly make mortgages much more affordable, and in this regard the HAMP model is successful in meeting its affordability goal. As noted by major mortgage loan servicers Larry Litton of Litton Loan Servicing and Allen Jones of Bank of America at the Panel's foreclosure mitigation field hearing, the requirement may need to be lowered, however, to assist borrowers in arrearages.[136] In particular, it appears that interest rate reductions alone are typically sufficient to make monthly payments affordable.

Possible Restrictions on Modifications. HAMP may be more restricted in its ability to achieve affordability through other means. A debate has emerged in the academic literature about the importance of the obstacles posed by PSAs to mortgage modification. An empirical study by John Patrick Hunt found that direct contractual prohibitions on modification are not common, although they do occur, and many PSAs are simply vague.[137] The notable exception is that virtually every PSA restricts the ability to stretch out a loan's term; loan terms may not be extended beyond the final maturity date of other loans in the pool. These provisions are designed to limit cash flow on securitized mortgages to the term of the securities issued against the mortgages. Securitized loans are typically all from the same annual vintage give or take a year, which means that the ability to stretch out terms is usually limited to a year at most. Not surprisingly, HAMP modifications stretch out terms by about a year on average.

The inability to stretch out terms for more than a year in most cases has a serious impact on HAMP modifications because it removes one of the tools and instead encourages principal forbearance, which has the result of creating loans with amortization periods that are longer than the loan term, meaning that a balloon payment of principal will be due at the end of the loan.

f. Securitized vs. Non-Securitized

Non-HAMP modification data also indicate that there are significant differences in modifications between securitized and non-securitized loans. OCC/OTS' joint Mortgage Metrics Reports for the first and second quarters of 2009 (not covering HAMP modifications) indicate that while the majority of modifications were on securitized loans, in particular those held in private-label pools (see Figure 21, below), very few loan modifications have involved principal balance reductions or even principal balance deferrals, and almost all principal reductions and deferrals were on non-securitized

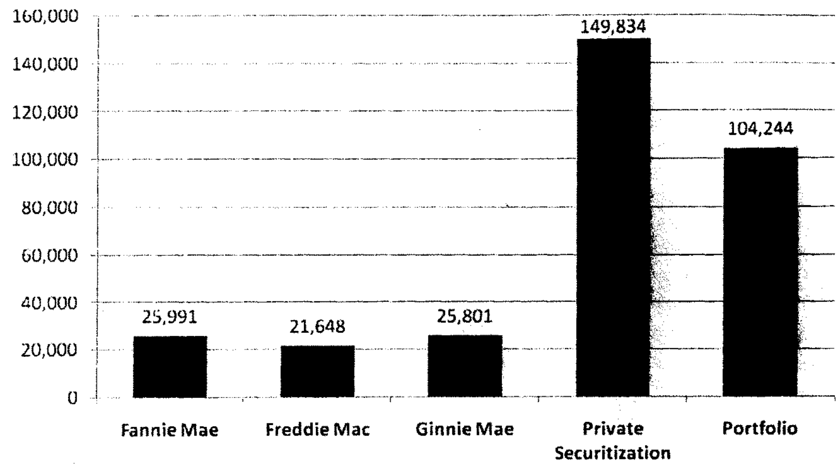
[135] Treasury Mortgage Market Data, *supra* note 111.

[136] Congressional Oversight Panel, Written Testimony of Litton Loan Servicing President and CEO, Larry Litton, *Philadelphia Field Hearing on Mortgages,* at 2–3 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony-092409-litton.pdf) (hereinafter "Litton Philadelphia Hearing Written Testimony"); Congressional Oversight Panel, Testimony of Bank of America Home Loans Senior Vice President for Default Management, Allen H. Jones, *Philadelphia Field Hearing on Mortgage Foreclosures,* at 5 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony-0924090jones.pdf).

[137] Hunt Subprime Contracts Paper, *supra* note 73.

loans.[138] (See Figure 22, below.) Out of 327,518 loan modifications in the OCC/OTS data in the first two quarters of 2009, only 17,574 (5.4 percent) involved principal balance reductions. All but eight of those 17,574 principal balance reductions were on loans held in portfolio. (See Figure 23, below.) The other eight are likely data recording errors.

Figure 21: Totals of Modifications by Loan Ownership, OCC/OTS Mortgage Metrics Q1-Q2, 2009[139]



[138] Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, First Quarter 2009* (online at www.occ.treas.gov/ftp/release/2009-77a.pdf) (June 2009) (hereinafter "OCC and OTS First Quarter Mortgage Report"); OCC and OTS Second Quarter Mortgage Report, *supra* note 42.

[139] Treasury Mortgage Market Data, *supra* note 111.

Figure 22: Modifications by Type by Loan Ownership, OCC/OTS Mortgage Metrics Q1-Q2, 2009

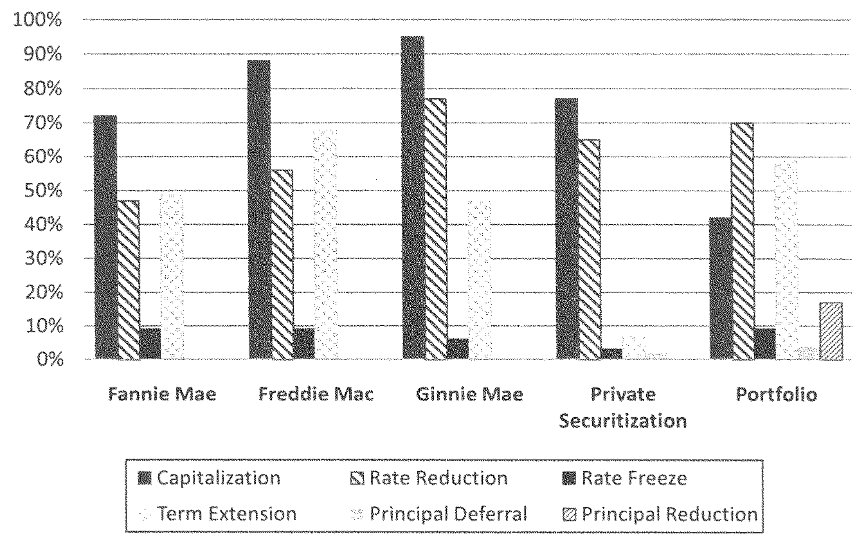
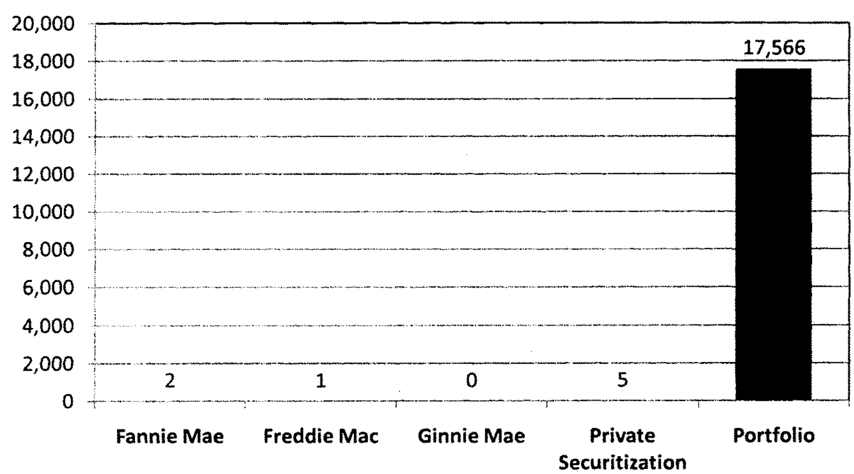


Figure 23: Number of Principal Reductions in Modifications by Loan Ownership, OCC/OTS Mortgage Metrics Q1-Q2, 2009



A similar discrepancy emerges for term extensions. Loans guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae/FHA can be bought out of a securitized pool and modified, making them more like portfolio loans. Thus in the OCC/OTS data for the first and second quarters 2009, 60 percent of portfolio loan, 49 percent of Fannie Mae, 69 percent of Freddie Mac, and 46 percent of Ginnie Mae modifications involved term extensions, but only 7 percent of private-label securitization did so. (See Figures 24 and 25, below.)[140] Whether the heterogeneity between modifications of securitized and nonsecuritized loans is a function of PSAs or of incentive misalignment between servicers and MBS holders is unclear, but there is clearly a difference, and this may be responsible for some of the difference in redefault rates.[141] (See Figure 26, below.)

[140] The ability to stretch out a term is separate from the ability to stretch out amortization periods and reduce monthly payments by creating a balloon payment at the end of the mortgage. A term extension produces a very different looking mortgage than an amortization extension alone.

[141] The data presented in the OCC/OTS Mortgage Metrics Reports has improved steadily from quarter to quarter and it provides one of the most valuable sources of information on modifications efforts. Currently, however, OCC/OTS data does not break down redefaults by type of modification beyond change in payment. Such data are critical for gaining an understanding of whether the type of modification affects redefaults. The Panel urges OCC and OTS to undertake this analysis in future Mortgage Metrics reports, as well as to present redefault rates beyond 12 months. OCC and OTS First Quarter Mortgage Report, supra note 138; OCC and OTS Second Quarter Mortgage Report, *supra* note 42.

Figure 24: Term Extensions as Percentage of Modifications by Loan Ownership, OCC/OTS Mortgage Metrics Q1-Q2, 2009

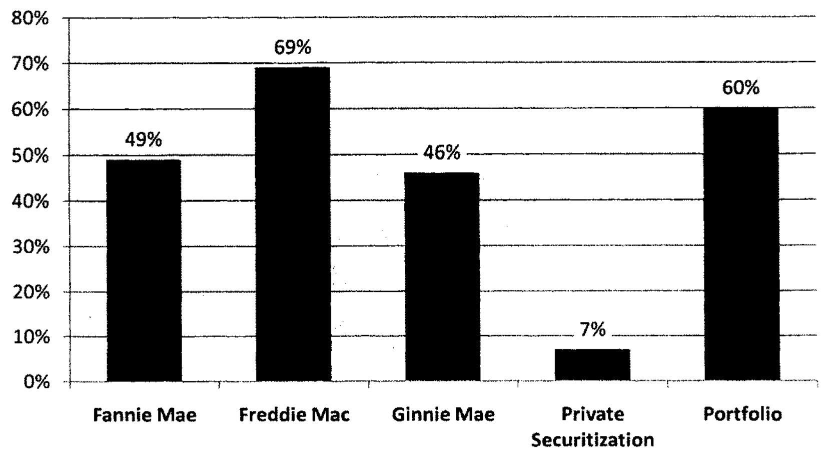


Figure 25: Number of Term Extensions in Modifications by Loan Ownership, OCC/OTS Mortgage Metrics Q1-Q2, 2009

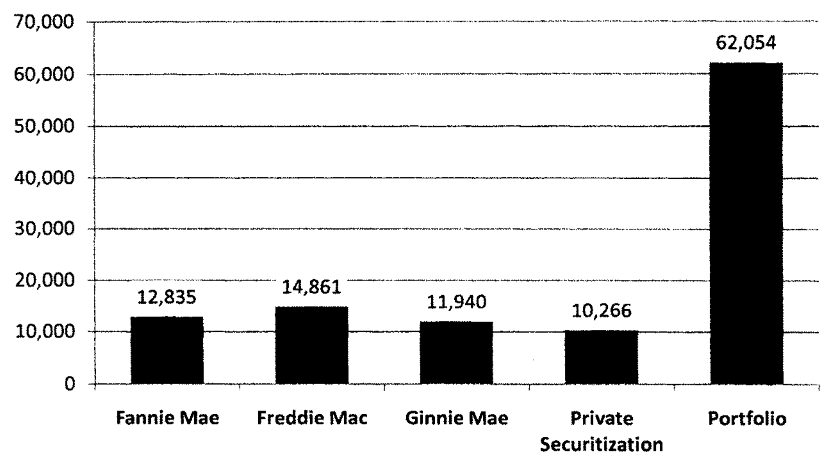
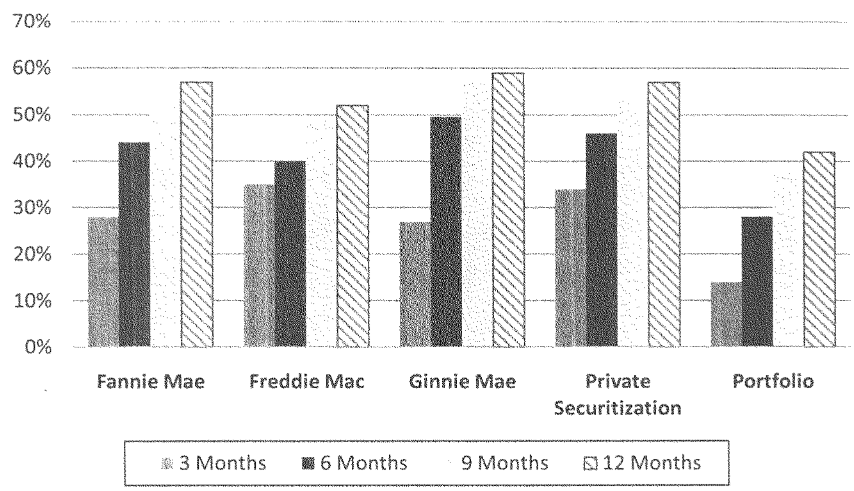


Figure 26: Redefault Rates by Loan Ownership, OCC/OTS Mortgage Metrics Q2, 2009



Notwithstanding the significant PSA constraint on term extensions that means that HAMP modifications are likely to look quite different from portfolio loan modifications as well as the evidence from the OCC/OTS Mortgage Metrics Reports, a recent working paper from the Federal Reserve Bank of Boston argues that there is no difference in the rate at which securitized and nonsecuritized loans are being modified; both have been modified at exceedingly low rates.[142] Two recent papers disagree with this finding. Professors Anna Gelpern and Adam Levitin contend that securitization creates obstacles to loan workouts that go beyond the formal contractual language analyzed by Hunt.[143] Professors Tomasz Piskorski, Amit Seru, and Vikram Vig analyzed data through the first quarter of 2008 and concluded that securitized loans are as much as 32 percent more likely to go into foreclosure when delinquent than loans held directly by banks, and are 21 percent more likely to become current within a year of delinquency.[144]

g. Servicer Ramp-up Period

Treasury has made significant progress towards its goal of broad servicer participation; however, signed participation agreements do not necessarily mean that servicers are fully ready to participate. The Panel recognizes that HAMP in particular requires a significant technological infrastructure to monitor modifications and servicer payments, and that this infrastructure is not something

[142] Manuel Adelino, Kristopher Gerardi, & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization*, Federal Reserve Bank of Boston Working Paper 09–4 (July 6, 2009) (hereinafter "Redefaults, Self-Cures, and Securitization Paper").

[143] Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 Southern California Law Review__(forthcoming 2009) (hereinafter "Gelpern & Levitin Frankenstein Contracts").

[144] Tomasz Piskorski, Amit Seru, & Vikrant Vig, *Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis*, Chicago Booth School of Business Research Paper No. 09–02 (Aug. 2009) (online at ssrn.com/abstract=1321646) (hereinafter "Piskorski, Seru, & Vig Renegotiation Paper").

that can be created overnight. The infrastructure has to allow many servicers to interface with Treasury and Fannie Mae, Treasury's agent for HAMP modifications. Servicers use a variety of software platforms, and the standard servicing platform, distributed by Lender Processing Services, Inc., does not have the ability to process modifications. As a result, even as of the end of August 2009, servicers still needed to provide hand-extracted data to Treasury, which slowed the process.

While the Panel is sympathetic to the difficulties in creating the infrastructure for HAMP, during the ramp-up period some homeowners who would have qualified for modifications did not have the opportunity. At this point, however, HAMP is up and running, and its ability to increase the number of modifications depends primarily on servicer staffing constraints and homeowner participation. When borrowers contact their servicers, either on their own or with the assistance of their lenders, they are often unable to make contact with someone who can provide accurate, timely information and help them obtain a modification.

As servicers ramp up their programs, many borrowers are facing long hold times and repeated transfers and disconnections on the telephone, lack of timely responses, lost paperwork, and incorrect information from servicers. Judge Annette Rizzo of the Court of Common Pleas, First Judicial District for Philadelphia County, recently expressed her frustration with the lack of clear information about MHA during her testimony at the Panel's September hearing.[145] Judge Rizzo is the architect of a foreclosure prevention program in Philadelphia that has moved cases through the pipeline more quickly by requiring prompt, face-to-face mediation sessions. According to Judge Rizzo, there is a need at the national level for a hotline or another easy access point for quick resolution of questions regarding the interpretation of various aspects of the MHA program.[146]

There is also evidence that eligible borrowers are being denied incorrectly. Eileen Fitzgerald, chief operating officer of NeighborWorks America, provided insight into this problem during her testimony at the Panel's foreclosure mitigation field hearing. Ms. Fitzgerald noted in both her written and oral testimony not only reports of such incorrect interpretations of the program, but also of delays in processing due to servicers misplacing documents or requesting duplicate documents, lack of uniform procedures and forms, and a need for access to servicers' NPV models to assist borrowers and their counselors in understanding why an application may have been denied.[147] Treasury's new requirement that servicers provide a reason for denials to both Treasury and to borrowers could help to alleviate this.[148] Denial codes can also help

[145] Congressional Oversight Panel, Testimony of Judge Annette M. Rizzo, Court of Common Pleas, First Judicial District, Philadelphia County; Philadelphia Mortgage Foreclosure Diversion Program, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 81–83 (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm).

[146] *Id*.

[147] *Id*. Congressional Oversight Panel, Testimony of NeighborWorks America Chief Operating Officer, Eileen Fitzgerald, *Field Hearing in Philadelphia on Mortgage Foreclosures* (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony-092409-fitzgerald.pdf) (hereinafter "Fitzgerald Philadelphia Hearing Testimony").

[148] Alexandra Andrews, *Frustrated Homeowners Turn to Media, Courts* ProPublica (Oct. 1, 2009) (online at www.propublica.org/ion/bailout/item/frustrated-homeowners-turn-to-media-courts-on-making-home-affordable-101) (hereinafter "Andrews Frustrated Homeowners").

protect against discrimination in refinancing. HMDA data from 2008 show that 61 percent of African-Americans were turned down for a refinancing, 51 percent of Hispanics were denied a refinancing, and 32 percent of Caucasians were denied.[149] Clear, prompt denial codes with a right of appeal are one way to help prevent possible discrimination and disproportionate destabilization of minority neighborhoods.

Externally, borrowers can face language or education barriers, both of which can be addressed by trustworthy and reliable housing counselors.[150] Treasury also plans to create a web portal to provide information to borrowers and servicers, and is working with Freddie Mac, in the GSE's role as compliance agent, to develop a "second look" process by which Freddie Mac will audit a sample of MHA modification applications that have been denied.[151]

Performance Variations Among Servicers. Substantial variation among servicers in performance and borrower experience, as well as inconsistent results in converting trial modification offers into actual trial modifications, remain significant issues.[152] Through August 2009, of the estimated HAMP-eligible 60+ day delinquencies, 19 percent were offered trial plans, and 12 percent entered trial modifications.[153] The percentage of HAMP-eligible borrowers entering trial modifications varied widely by servicer, from 0 percent to 39 percent.[154] This means that more than two-thirds of eligible borrowers potentially missed their opportunity to avoid foreclosure. Treasury is taking steps to increase the number of eligible borrowers who may participate. On July 28, Treasury officials met with representatives of the 27 servicers participating at that time. At this meeting, servicers pledged to increase "significantly" the rate at which they were performing modifications.[155] Treasury acknowledges that servicers have a ramp-up period: "Servicers are still working to incorporate program features in their systems and procedures, adding new program requirements as they are introduced." [156]

There has been considerable variation in the number of permanent HAMP modifications by servicer, with servicers that have required full documentation before commencing a modification having significantly higher rates of conversion from trial to permanent modifications. Because data on permanent modifications is still preliminary, and because of the two-month extension that Treasury has granted no/low-documentation trial modifications to assemble full documentation, the Panel is refraining at this point from presenting an analysis of servicer-by-servicer conversion rates from

[149] Robert B. Avery, et al., *The 2008 HDMA Data: The Mortgage Market during a Turbulent Year, Federal Reserve Bulletin*, at 69 (online at www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft.pdf) (accessed Oct. 6, 2009).

[150] House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, Testimony of National Council of La Raza Legislative Analyst, Graciela Aponte, *Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System* (Mar. 11, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs__dem/aponte031109.pdf).

[151] Wheeler Philadelphia Hearing Testimony, *supra* note 88.

[152] Campbell Real Estate Agent Survey, *supra* note 5.

[153] Servicer Performance Report, *supra* note 95.

[154] Servicer Performance Report, *supra* note 95.

[155] U.S. Department of Treasury, *Administration, Servicers Commit to Faster Relief for Struggling Homeowners through Loan Modifications* (July 29, 2009) (online at financialstability.gov/latest/07282009.html).

[156] Allison COP Testimony, *supra* note 94, at 4–5.

trial to permanent loans. This is an issue that the Panel plans to reexamine in a future report when more robust data is available.

Treasury Efforts to Improve Performance. In recognition of this concern, Treasury has prioritized servicer capacity to respond to borrowers. While Treasury recognizes that "capacity is key to the success of HAMP," [157] current servicer capacity remains an area of concern. In testimony before a House Financial Services subcommittee hearing, Treasury Assistant Secretary for Financial Institutions Michael Barr noted the following:

> On July 9, as a part of the Administration's efforts to expedite implementation of HAMP, Secretaries Geithner and Donovan wrote to the CEOs of all of the servicers currently participating in the program. In this joint letter, they noted that there appears to be substantial variation among servicers in performance and borrower experience, as well as inconsistent results in converting trial modification offers into actual trial modifications. They called on the servicers to devote substantially more resources to the program in order for it to fully succeed.[158]

To combat this problem, Treasury has tasked Freddie Mac to conduct readiness reviews of participating servicers and report the results back to Treasury.[159]

Further, Treasury tracks outcomes as an incentive for servicers to scale up their operations to meet demand. Treasury publishes monthly statistics on HAMP that track, among other things, how many eligible borrowers to whom each servicer has offered a trial modification and how many have entered trial modifications.[160] Additionally, Treasury is working to develop more exacting metrics to measure the quality of borrower experience, such as average borrower wait time for inbound inquiries, completeness and accuracy of information provided to applicants, as well as response time for completed applications.[161]

h. Servicer Concerns About the HAMP Program

Servicers voice a number of criticisms and concerns regarding the HAMP program. Failure to address these concerns could limit the effectiveness of HAMP. In June, the Panel sent a questionnaire to the 14 largest servicers that were not yet participating in HAMP.[162] Of the 13 servicers that responded, only two stated that

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[157] Letter from Secretaries Geithner and Donovan to Servicers (July 9, 2009) (online at www.housingwire.com/wp-content/uploads/2009/07/servicer-letter.pdf).

[158] Barr Hearing Testimony, *supra* note 87.

[159] Barr Hearing Testimony, *supra* note 87.

[160] It is not yet known whether the publication of these reports will induce lenders to increase participation. For example, Bank of America and Wells Fargo's borrower participation rose sharply after showing weak numbers in the first monthly report. However, this could have been due to the banks' ramp-up period in implementing the program. Servicer Performance Report, *supra* note 95.

[161] U.S. Department of the Treasury, *Making Home Affordable Program on Pace to Offer Help to Millions of Homeowners* (Aug. 4, 2009) (online at www.financialstability.gov/latest/tg252.html).

[162] Surveys were sent to Accredited Home Lenders, American Home Mortgage Servicing, American General Finance Inc, Citizens Financial Group, Fifth Third Bancorp, HSBC, Home Eq Servicing, ING Bank, Litton Loan Servicing, PNC Financial Services Group, Sovereign Bancorp Inc., SunTrust Banks Inc., and U.S. Bancorp. Only Accredited Home Lenders failed to provide a response. As of August 13, nine of the servicers had either already signed up to participate in the program or were in the process of signing contracts to participate. Surveys Sent by the Panel to Various Loan Servicers (June 30, 2009) (hereinafter "Survey of Lenders").

they did not plan to participate in HAMP. As primary justification, both of these servicers stated that they believed that their own modification programs provided borrowers with more aggressive and flexible relief than did HAMP, allowing more borrowers to receive modifications. One explained that under its own program, it uses "a more holistic review of income and expenses [as compared to] the MHA gross income versus primary mortgage debt model." Another "performs a disposable income analysis rather than impos[ing] a fixed debt-to-income requirement." It "subtract[s] mortgage payments, property taxes, homeowners' insurance, verifiable utilities, and medical and day care expenses from the customer's net income."

The questionnaire asked servicers what they believed to be barriers to full participation in HAMP. Among the most common responses was that the program required cumbersome documentation and trial periods. One servicer suggested amending documentation requirements "to mirror current bank-owned work-out options."[163] A servicer that is choosing not to participate in HAMP believed that gathering the required documentation would take between 45 to 50 days under HAMP, while under the servicer's own program, the average decision time, including collection of documents, was 10 to 12 days.[164]

Another perceived barrier to full participation is the concern that the program's details continue to change. One servicer cited "ongoing clarifications of, and additions to, the requirements and guidelines issued by the Treasury and its agents, Fannie Mae and Freddie Mac."[165] Another stated that "the ongoing evolution of program benefits and requirements has presented challenges (for example, [the] ability to timely recruit, hire, and train staff for functions that are still being defined)."[166] Some servicers reported that it took substantial manpower to implement the required system changes.[167] Among the other perceived barriers to full participation are questions about servicer liability, difficulty in obtaining investor approval to amend servicing agreements, different reporting standards between GSEs and Treasury, and a lack of flexibility in the escrow requirement.

Treasury has made substantial progress towards reaching its projection of having 90 percent of HAMP-eligible mortgage debt serviced by participating servicers, but more efforts are needed before significant percentages of eligible borrowers receive modifications.[168] As servicers take time to implement their programs and fully train their staff, families are losing their homes. Treasury must encourage and provide support to enable servicers to make modifications available to as many borrowers as possible, as quickly as possible.

[163] Survey of Lenders, *supra* note 162.
[164] Survey of Lenders, *supra* note 162.
[165] Survey of Lenders, *supra* note 162.
[166] Survey of Lenders, *supra* note 162.
[167] Survey of Lenders, *supra* note 162.
[168] It is possible that a significant number of HAMP-eligible borrowers are receiving modification through servicers' non-HAMP programs. Treasury, possibly through Freddie Mac's audit function, should compile and analyze this set of modifications, as it does for HAMP modifications.

i. Prospects for Long-Term Effectiveness

The program is completely dependent upon servicers to provide adequate capacity and quality in order to make HAMP a success. Therefore, it is important to consider the longer term prospects for servicers to provide that quality and capacity in evaluating the longer term outlook for HAMP.

HAMP relies on mortgage servicers to perform the modifications. Residential mortgage servicers, however, are not normally in the modification business.[169] Residential mortgage servicing combines a transaction processing business with a loss mitigation business. Transaction processing is a business given to automation and economies of scale. Loss mitigation, in contrast, involves intense discretion and human capital and is cyclic with the occurrence of severe recessions. In normal times, loss mitigation is a small part of any servicing operation.

While there were some episodes of serious cyclic foreclosure, such as in New England in the early 1990s, on the whole, mortgage defaults were historically sparse and random, so it made little business sense for most servicers, other than subprime specialists, to invest in loss mitigation capacity. Investors did not want to pay for this capacity, and servicing fee arrangements did not budget for it, particularly in light of the lack of demand. Because servicers did not invest in loss mitigation capacity during boom times, they now lack sufficient loss mitigation capacity. There is a limited supply of trained, experienced loss mitigation personnel, although it is likely that there are many out-of-work underwriters and originations personnel available, and the standard servicing computer platform lacks the ability to process loan modifications.

For HAMP to succeed, the entire servicing industry has had to shift into a new line of business. To incentivize this business model transformation, HAMP offers servicers payments for every modified mortgage. This incentive payment is paid on top of servicers' regular compensation, which is supposed to cover appropriate loss mitigation. At this point, the transition and re-tooling period should be over, and servicers' loss mitigation units should be expected to be operating at capacity.

j. Incentive Payment Sufficiency

Incentive payments might be insufficient to offset other servicer incentives that push for foreclosure even when modification increases the net present value of the loan.[170] As noted by Deborah Goldberg at the Panel's foreclosure mitigation field hearing, "there are many incentives for servicers to continue moving a loan toward foreclosure during the HAMP review process."[171] Servicers typically purchase mortgage servicing rights (MSRs) for an upfront payment based on the outstanding principal balance of the loans in the servicing portfolio. The servicer's pricing of the MSRs depends primarily on the servicing fee, anticipated prepayment rates (in-

[169] In contrast, the commercial mortgage servicing market is designed with the need for loan modifications in mind. Gelpern & Levitin Frankenstein Contracts, *supra* note 143.

[170] Senate Committee on the Judiciary, Testimony of Professor Adam J. Levitin, *Helping Families Save Their Homes: The Role of Bankruptcy Law,* 110th Cong., at 11 (Nov. 19, 2008) (online at www.law.georgetown.edu/faculty/levitin/documents/LevitinSenateJudiciaryTestimony.pdf).

[171] Goldberg Philadelphia Hearing Written Testimony, *supra* note 99.

cluding defaults), and on the anticipated costs of servicing the loans. The servicing fee is typically in the range of 25–50 basis points per annum of the outstanding principal balance of the loans in the portfolio and gets paid before investors in the mortgages are paid.

Servicers are obligated to advance monthly payments of principal and interest on defaulted loans ("servicing advances") to investors until the property is no longer in the servicing portfolio (as the result of a refinancing or sale) or if the servicer reasonably believes it will not be able to recover the servicing advances. While servicers are able to recover their servicing advances upon liquidation of the property, they are not able to recover the time value of the advances; given that timelines of default to foreclosure are now in the range of 18–24 months in most parts of the country, servicers have significant time-value costs in making servicing advances, particularly if they lack low-cost funding sources like a depositary base or access to the Federal Reserve's Discount Window.

Because servicers prepay for their MSRs, their profitability depends on prepayment speeds and maintaining low operations costs. Most servicers hedge their prepayment risk to the extent it is an interest rate risk. Some also hedge against prepayment speeds due to default risk through buying credit default swap protection on either their particular portfolios or on indices like the ABX. Servicers, however, are unable to hedge against servicing costs effectively, and foreclosures impose significant operational costs on servicers.

Consider a servicer that receives 37.5 basis points per year on a mortgage loan with an unpaid principal balance of $200,000. The servicer might have paid $1,000 to acquire the MSR for that loan. The servicer's annual servicing fee income is $750. The servicer will then add to this a much more modest amount of float income from investing the mortgage payments during the period between when the homeowner pays the servicer, and the servicer is required to remit the funds to the investors. This income might amount to $20-$40 per year. A typical performing loan might cost in the range of $500/year to service, which means that the servicer will turn a profit on the loan.

If the loan becomes delinquent, however, it will cost the servicer $1,000/year to service, both because of additional time and effort involved as well as the cost of servicing advances.[172] The sooner the servicer can foreclose on the loan, the sooner the servicer can cut loose a money-losing investment. Moreover, the foreclosure itself might present an opportunity to levy various ancillary fees that do not need to be remitted to investors, but which can instead be retained by servicers, such as late fees and property maintenance fees. Thus foreclosure can not only cut losses, but it can be an affirmative profit center.[173]

In contrast, if the servicer modifies the defaulted loan, the servicer will still lose the time-value of the servicing advances it made; will incur a significant administrative cost to performing the

[172] Piskorski, Seru, & Vig Renegotiation Paper, *supra* note 144.

[173] Katherine M. Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims,* 87 Texas Law Review 121, 127—0928 (2008). (hereinafter "Porter Bankruptcy Mortgage Claims").

modification, estimated at as high as $1,500;[174] will have no opportunity to levy additional fees; and will assume a risk that there will be a redefault, which will add to the servicer's time-value and operations costs. While the precise calculations of servicers in these circumstances are not known, there is a strong inference that servicers' incentives may not be aligned with those of investors in the mortgages. Indeed, private mortgage insurers, who bear the first loss on defaults on insured loans—making them like investors—have recently expressed sufficient concern about servicer loss mitigation practices that they have insisted on inserting personnel into servicing companies to supervise loss mitigation.[175]

HAMP provides servicers with taxpayer-funded modification incentive payments in addition to their preexisting contractual payments from investors in order to encourage servicers to perform more modifications, to the extent that they would maximize net present value. While servicers are contractually obligated to maximize value for mortgage investors and are already compensated for their services, HAMP provides additional, taxpayer-funded compensation for servicers to perform the same services. The goal of this extra compensation is to make the servicers' incentives look like those of a portfolio lender, with the hope that this will negate any incentive misalignments that encourage servicers to seek foreclosure. If so, both investors and financially distressed homeowners will win, as well as the neighbors of the homeowners and their communities.

By all estimates, HAMP incentive payments more than cover the cost of modifications, excluding overhead.[176] The incentive payment amounts might still be insufficient, however, to counterbalance servicers' incentive to pursue foreclosure because servicers are reluctant to invest in a loss mitigation business that is unlikely to have long-term value.[177] Moreover, given the limited supply of modification specialists, who cannot be trained overnight, the capacity problem may simply be impervious to incentive payments of any reasonable level. The economics of servicing are still not fully understood, and this presents a challenge for any attempt to craft an incentive-based modification program.

That said, successful HAMP modifications should result in an increase in the value of MSRs by reducing prepayment speeds, both due to defaults and to refinancings. Prepayments due to refinancings are largely a function of interest rates; as rates drop, prepayment speeds increase. Refinancings, however, are only possible when there is positive equity.

HAMP modifications result in extremely low interest rates and negative equity. The combination means that HAMP-modified loans, to the extent they do not redefault, are unlikely to be refinanced. First, HAMP-modified loans have interest rates that are initially so low that it is unlikely that the borrower could find a lower interest rate.[178] And second, even if a lower rate were avail-

[174] Joseph Mason, *Mortgage Loan Modification: Promises and Pitfalls,* SSRN Working Paper Series (Oct. 3, 2007) (online at papers.ssrn.com/sol3/papers.cfm?abstract__id=1027470).

[175] Harry Terris and Kate Berry, *Pipeline,* American Banker vol. 174, no. 163 (Aug. 27, 2009).

[176] Piskorski, Seru, & Vig Renegotiation Paper, *supra* note 144.

[177] Redefaults, Self-Cures, and Securitization Paper, *supra* note 142.

[178] Under the terms of HAMP modification, interest rates are tied to the Freddie Mac Primary Mortgage Market Survey rate (market rate) on the date that the modification agreement was

able, negative equity precludes refinancing. HAMP modifications thus have drastically slow prepayment speeds, which boosts the value of MSRs.

For example, JPMorgan Chase has reduced interest rates in some modifications so they are just enough to cover its servicing fee, but left principal balances untouched.[179] Modifications like this ensure that the value of MSRs to the servicer will be maximized, as servicing fee income will not be reduced (as would occur if principal balances were reduced) and refinancing is likely precluded both because of low rates and likely negative equity. Unfortunately, while a modification like this might maximize value for the servicer, it might not be the optimal modification for the homeowner or the investors. Thus, while HAMP is aimed at correcting misaligned incentive problems, it might actually overcorrect and result in sub-optimally structured modifications.

The benefit HAMP could provide to servicers in the form of increased MSR values is tempered by the risk that servicers assume on a loan redefault. A defaulted loan is worse than a prepayment in terms of MSR value, because not only is the principal balance of the trust reduced, but the servicer must make servicing advances of principal and interest until the property is sold from the trust, either at a foreclosure sale to a third-party or from REO. While servicing advances are reimbursable, no interest is paid on them, resulting in a time-value loss for the servicer. The time-value costs of a defaulted mortgage are one of the largest costs for a servicer, especially in a depressed market where foreclosures are taking longer and properties are sitting in REO for months if not years.

HAMP payments may well offset the cost of redefault risk for servicers, in addition to the costs of modification, which are estimated in the $1,000 range.[180] This raises the question of why servicers are not engaged in more modifications. The answer may simply be a capacity constraint, but another consideration is that it is difficult for servicers to determine ex-ante whether a loan will redefault post-modification and thus figure out the net benefit of modification.[181] If servicers do not believe that modifications as a whole are sustainable, they will be reluctant to engage in them beyond the likely sustainable ones they can cherry-pick. Again, HAMP is designed to address servicer reluctance to engage in modifications through incentive payments, but this sort of targeted incentive payment only makes sense when an economic structure is fully understood.

Servicer capacity remains a weak link in the system, and it is unclear whether HAMP incentive payments are sufficient to change the situation. Servicers may be reluctant to invest in modification capacity that will have a limited useful lifespan. In addi-

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prepared. If the modified rate is below the market rate on this date, the modified rate is fixed for the first five years. In the sixth year, the modified rate may increase up to one percentage point annually until it reaches the market rate listed in the modification agreement. If the modified rate equaled or exceeded the market rate when the modification agreement was prepared, the modified rate is fixed for the life of the loan.

[179] Mike Greggory, *Chase Serves Itself First in Mortgage Modifications; MBS Bond Holders Up in ARMs,* Financial Times (July 27, 2009) (online at www.ft.com/cms/s/2/a6f6db88-097aee0911de098c340900144feabdc0.html).

[180] Piskorski, Seru, & Vig Renegotiation Paper, *supra* note 144.

[181] Redefaults, Self-Cures, and Securitization Paper, *supra* note 142.

tion, there might simply be an inelastic supply of modification capacity, which would make modification capacity impervious to incentives. Ensuring that modification efforts are not hobbled by lack of capacity is essential if HAMP is to be successful, but it does not appear that Treasury has undertaken any concrete steps to ensure that the capacity issue is resolved.

One possible solution to the problem of servicer incentives or capacity constraints is to provide supplemental capacity, such as contracting with third-party originators to modify the loans as if they were underwriting new loans. Loan modification is essentially loan underwriting, which is not where servicer talents and expertise lie. While there are coordination and privacy issues involved with utilizing third-party originators for modifications, third-party originators could provide an effective option.

k. Possible Litigation Risk for Servicers

HAMP may itself be creating litigation risk for servicers, as there is a question about how principal forbearance is to be treated by securitization trusts for the purposes of allocating cash flow among investors. Treasury has advised that principal forbearance should be treated as a loss to the trust, with any later payment as a loss recovery, but Treasury has also noted that the trust documents control.[182] Many servicers and securitization trustees are therefore reviewing the trust documents to determine the appropriate interpretation. To the extent that principal forbearance is treated as a loss, however, it would reduce the outstanding principal balance in the trust, which would reduce the servicer's servicing fee compensation.

3. Second Lien Program

One component of HAMP is the Second Lien Program. Originally released in mid-February, the plan to assist homeowners included an initiative to lower monthly mortgage payments, but it failed to address in detail a related issue that threatens to undo troubled borrowers: second liens. Treasury states that as many as 50 percent of at-risk mortgages also have second liens.[183] Second liens can interfere with the success of loan modification programs for three reasons. First, modifying the first lien may not reduce homeowners' total monthly mortgage payments to an affordable level if the second mortgage remains unmodified.[184] While some homeowners might be able to afford a modified first mortgage payment, a second unmodified mortgage payment can make monthly mortgage payments unaffordable, increasing redefault risk.[185] Second, when a first mortgage is refinanced, the lender doing the refinancing will have a junior lien to any previously existing mortga-

[182] U.S. Department of the Treasury, *Supplemental Documentation FAQs* (Aug. 19, 2009) (online at www.hmpadmin.com/portal/docs/hamp__servicer/hampfaqs.pdf). These two directives can be seen as inconsistent.

[183] MHAP Update, supra note 69. Senate Committee on Banking, Housing, and Urban Affairs, Written Testimony of U.S. Department of Housing and Urban Development Senior Advisor for Mortgage Finance, William Apgar, *Preserving Homeownership: Progress Needed to Prevent Foreclosures* (July 16, 2009) (online at www.hud.gov/offices/cir/test090716.cfm) (hereinafter "Apgar Senate Testimony"); House Testimony of Dave Stevens, *supra* note 71.

[184] Although HAMP reduces mortgage payments to 31 percent of the borrower's monthly income, payments on junior liens are not included in that calculation.

[185] MHAP Update, *supra* note 69, at 1.

gees unless they agree to resubordinate their liens to the refinanced mortgage. Second liens, therefore, have the potential to hinder or prevent efforts to refinance a first mortgage.[186] Third, second liens also increase the negative equity that can contribute to subsequent redefaults.

Treasury established the Second Lien Program with two primary goals in mind: (1) to allow 1 to 1.5 million homeowners to benefit from reduced payments on their second mortgages—equaling up to 50 percent of HAMP participants; and (2) to maximize and enhance the effectiveness of Treasury's first lien modification program.[187]

Under the Second Lien Program, when a HAMP modification is initiated on a first lien, servicers participating in the Second Lien Program will automatically reduce payments on the associated second lien by modifying or extinguishing the second lien.[188] Accordingly, Treasury has emphasized that modification of a second lien should not delay modification of a first lien, but will occur as soon as the second lien servicer is able to formulate the terms and make contact with the borrower.[189] However, since the Second Lien Program is voluntary, automatic modification of the second lien is not required if the second lien servicer chooses not to participate in the Second Lien Program. According to the Second Lien Program guidelines, the amount of funds available will be capped based upon each servicer's Servicer Participation Agreement (SPA).[190] Treasury will formulate each servicer's initial program participation cap by "estimating the number of modifications and extinguishments expected to be performed by each servicer" during the life of HAMP.[191] Second lien modification does not go into effect "until the first lien modification becomes effective under HAMP" and the borrower has made each second lien trial period payment "by the end of the month in which it is due."[192]

The Second Lien Program has several eligibility factors. First, only second liens originated on or before January 1, 2009 are eligible for a modification or extinguishment under this program.[193] Second, only second liens with an unpaid principal balance equal to or greater than $5,000 are eligible for modification or cost share payments, while there is no such limitation with respect to any ex-

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[186] MHAP Update, *supra* note 69, at 1. The Panel addressed the complexities and challenges caused by junior liens in its March Oversight Report. The Panel noted that there are multiple mortgages on many properties, and that across a range of mortgage products, many second mortgages were originated entirely separately from the first mortgage and often without the knowledge of the first mortgagee. In addition, millions of homeowners took on second mortgages, often as home equity lines of credit. Since those debts also encumber the home, they must be dealt with in any viable refinancing effort. COP March Oversight Report, supra note 21.

[187] MHAP Update, *supra* note 69, at 1.

[188] U.S. Department of Housing & Urban Development, *Prepared Remarks for Secretary of Housing and Urban Development Shaun Donovan at the Mortgage Bankers Association National Policy Conference* (Apr. 24, 2009) (online at www.hud.gov/news/speeches/200909040929.cfm); MHAP Update, *supra* note 69, at 4.

[189] MHAP Update, *supra* note 69, at 4.

[190] SLMP Supplemental Directive, *supra* note 74.

[191] *Id.* It should be noted that *Supplemental Directive 09–05* provides guidance to servicers for implementation of the Second Lien Program for second liens that are not owned or guaranteed by Fannie Mae or Freddie Mac—that is, so-called "non-GSE second liens." The Directive explicitly directs servicers of second liens owned or guaranteed by Fannie Mae or Freddie Mac to refer to the Second Lien Program guidance provided by those entities.

[192] *Id.* A trial period is not required if a borrower is current on the existing second lien and the current payment amount is equal to or more then the monthly payment that will be due following the second lien modification.

[193] *Id.*

tinguishment of second liens.[194] Third, borrowers can participate in the program provided that they have fully executed a Second Lien Program modification agreement or entered into a trial period plan with the servicer by December 31, 2012.[195]

During his testimony before the Senate Committee on Banking, Housing, and Urban Affairs in July, Assistant Secretary Allison noted that the five banks that aggregately account for over 80 percent of the second liens are in negotiations to participate in the Second Lien Program.[196]

The Second Lien Program also contains a "pay-for-success" structure similar to the first lien modification program. Servicers can be paid $500 up-front for a successful modification and then receive successive payments of $250 per year for three years, provided that the modified first loan remains current.[197] If borrowers remain current on their modified first loan, they can receive payments of up to $250 per year for as many as five years.[198] This means that borrowers could receive as much as $1,250 for making payments on time. These borrower incentives would be directed at paying down the principal on the first mortgage, helping borrowers build equity in their home.[199]

The program gives participating servicers two options: (1) reduce borrower payments, or (2) extinguish the lien. The servicer's decision as to which option to pursue is based solely on the financial information provided by the borrower in conjunction with the HAMP modification.[200]

Under the first option, the MHA Program will share with lenders the cost of reducing second mortgage payments for homeowners.[201] For amortizing loans (loans with monthly payments of interest and principal), Treasury shares the cost of reducing the interest rate on the second mortgage to one percent.[202] The servicer reduces the loan interest rate to one percent, forbears principal in the same proportion as in the first lien modification, and extends the repayment and amortization schedule to match the modified first lien.[203] In turn, Treasury pays the servicer the incentive and success fees for making the modification, plus pays the lender half the difference between the interest rate on the first lien and one percent.[204] For interest-only loans, MHA shares the cost of reducing the interest rate on the second mortgage to two percent.[205] The servicer reduces the interest rate to two percent, forbears principal in the same proportion as in the first lien modification, and extends the repayment and amortization schedule to match the first lien.[206] Treasury pays the servicer an amount equal to half of the difference between (a) the lower of the contract rate on the second lien and the interest rate on the first lien as modified and (b) two

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[194] *Id.*
[195] *Id.*
[196] Allison Senate Testimony, *supra* note 105.
[197] SLMP Supplemental Directive, *supra* note 74.
[198] MHAP Update, *supra* note 69, at 3; SLMP Supplemental Directive, *supra* note 74.
[199] MHAP Update, *supra* note 69, at 3; SLMP Supplemental Directive, *supra* note 74.
[200] SLMP Supplemental Directive, *supra* note 74.
[201] MHAP Update, *supra* note 69, at 3; SLMP Supplemental Directive, *supra* note 74.
[202] MHAP Update, *supra* note 69, at 2; SLMP Supplemental Directive, *supra* note 74.
[203] MHAP Update, *supra* note 69, at 2; SLMP Supplemental Directive, *supra* note 74.
[204] MHAP Update, *supra* note 69, at 2; SLMP Supplemental Directive, *supra* note 74.
[205] MHAP Update, *supra* note 69, at 2; SLMP Supplemental Directive, *supra* note 74.
[206] MHAP Update, *supra* note 69, at 2–3; SLMP Supplemental Directive, *supra* note 74.

percent.[207] For both amortizing and interest-only loans that have been modified, the interest rate rises after five years, just as happens under HAMP. At the five-year mark, the interest rate in the Second Lien Program increases to the rate that is being charged at that time on the modified first mortgage.[208]

As an alternative to modifying the second lien, lenders/investors have the option to extinguish second liens in exchange for a lump-sum payment from Treasury under a pre-set formula.[209] While eligible first lien modifications will not require any participation by second lien holders, these incentives to extinguish second liens on loans modified under the program are intended to reduce the borrower's overall indebtedness and improve loan performance.[210] This option is intended to allow second lien holders "to target principal extinguishment to the borrowers where extinguishment is most appropriate."[211] Servicers will be eligible to receive compensation when they contact second lien holders and extinguish valid junior liens (according to a schedule formulated by Treasury, depending in part on combined loan-to-value).[212] Servicers will be reimbursed for the release according to the specified schedule, and will also receive an extra $250 for obtaining a release of a valid second lien.[213] For example, for loans that are more than 180 days past due at the time of modification, the lender/investor will be paid three cents per dollar extinguished.[214] For loans less than 180 days past due, Treasury will pay second lien holders a specified amount for each dollar of unpaid principal balance extinguished.[215]

The program is not yet operational, therefore no loans have been modified under the initiative. Without officially participating servicers and lenders and any preliminary data, the Panel is unable to determine whether or not the Second Lien Program will be able to eliminate the significant obstacle that second liens can present to loan modification.

4. Home Price Decline Protection Program

Building on ideas from the FDIC, Treasury has also developed a price decline protection initiative with the primary purpose of increasing the number of modifications completed under HAMP in those markets hardest hit by falling home prices.[216]

Treasury's articulated purpose for the Home Price Decline Protection (HPDP) is to encourage HAMP modifications in areas where homes have lost the most value. It does this by working to alleviate mortgage holder/investor concerns that recent home price declines may persist and "offset any incremental collateral losses on modifications that do not succeed."[217] Lenders may be more willing to offer modifications if potential losses are partially covered.

[207] MHAP Update, *supra* note 69, at 2–3; SLMP Supplemental Directive, *supra* note 74.
[208] MHAP Update, *supra* note 69, at 2–3; SLMP Supplemental Directive, *supra* note 74.
[209] MHAP Update, *supra* note 69, at 2.
[210] MHA March Update, *supra* note 80, at 5–6.
[211] MHAP Update, *supra* note 69, at 3.
[212] MHA March Update, *supra* note 80, at 5–6.
[213] MHA March Update, *supra* note 80; SLMP Supplemental Directive, *supra* note 74.
[214] MHAP Update, *supra* note 69, at 3; SLMP Supplemental Directive, *supra* note 74.
[215] MHAP Update, *supra* note 69, at 3; SLMP Supplemental Directive, *supra* note 74.
[216] HAMP Supplemental Directive, *supra* note 77; Allison Senate Testimony, *supra* note 105.
[217] House Testimony of Dave Stevens, *supra* note 71.

There are several factors relating to HPDP eligibility. First, all HAMP loan modifications begun after September 1, 2009 are eligible for HPDP payments.[218] As of September 1, HPDP payments became operational and were included in NPV calculations.[219] Treasury has made clear that no incentives will be provided if: (1) the servicer has not entered into a HAMP Servicer Participation Agreement; (2) the borrower did not successfully complete the trial period and execute a HAMP modification agreement; or (3) the HAMP loan modification did not reduce the borrower's monthly mortgage payment by at least six percent.[220] In addition, HPDP incentive compensation will terminate if the borrower loses good standing under HAMP (i.e., if he or she misses three successive payments on a HAMP modification) or if the borrower pays off the mortgage loan balance in full.[221] Second, mortgage loans that are owned or guaranteed by Fannie Mae or Freddie Mac are not eligible for HPDP incentive compensation.[222]

Program incentive payments are based upon the total number of modified loans that successfully complete the modification trial period and remain in the HAMP program. The HPDP incentive is structured as a simple cash payment on all eligible loans.[223] Each successful loan modification will be eligible for an HPDP incentive, up to a total cap for HPDP incentives of $10 billion (from the $50 billion designated for HAMP using TARP funding), but the actual amount spent will be dependent upon housing price trends.[224] Upon the completion of a successful trial modification, the lender/investor accrues 1/24th of the HPDP incentive per month for 24 months.[225] Incentive payments are calculated based on a Treasury formula incorporating an estimate of the projected home price decline over the next year based on changes in average local market home prices over the two previous quarters, the unpaid principal balance of the mortgage loan prior to HAMP modification, and the mark-to-market loan-to-value ratio of the mortgage loan prior to HAMP modification.[226] Incentives are to be paid on the first- and second-year anniversaries of the borrower's first trial payment due date under HAMP.[227] In other words, the incentive payments on all modified mortgages will help cover the "incremental collateral loss on those modifications that do not succeed."[228]

Because the program became active quite recently, performance data are not available. Treasury has not specified the number of loans it estimates will be covered by HPDP. All loans eligible for HPDP payments are also covered by incentive payments under the

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[218] U.S. Department of the Treasury, *Treasury Announces Home Price Decline Protection Incentives* (July 31, 2009) (online at www.financialstability.gov/latest/tg__07312009.html).
[219] Barr Hearing Testimony, *supra* note 87.
[220] HAMP Supplemental Directive, *supra* note 77.
[221] HAMP Supplemental Directive, *supra* note 77.
[222] HAMP Supplemental Directive, *supra* note 77.
[223] MHA March Update, *supra* note 80, at 5.
[224] MHA May Update, *supra* note 79. According to the HPDP guidelines, the amount of funds available to pay HPDP will be capped based upon each servicer's servicer participation agreement. Treasury will formulate each servicer's initial program participation cap by estimating the number of modifications expected to be performed by each servicer during the life of HAMP. HAMP Supplemental Directive, *supra* note 77.
[225] MHA May Update, *supra* note 79.
[226] HAMP Supplemental Directive, *supra* note 77.
[227] HAMP Supplemental Directive, *supra* note 77; Secretaries Geithner, Donovan Announcement, *supra* note 78.
[228] Secretaries Geithner, Donovan Announcement, *supra* note 78.

first lien program. As the Government Accountability Office (GAO) has noted, loans requiring a mandatory modification under the first lien program would nonetheless be eligible for additional payments under this program.[229] Treasury has not offered any estimates of the incremental modifications created by this program—that is to say, the number of lenders who agree to participate only because of the additional coverage against losses available through the HPDP program, plus the number of non-mandatory modifications that lenders may be willing to make because of the additional protection against losses. Without such information, it is unclear why the program should provide additional payments for modifications that would have been made anyway.

5. Foreclosure Alternatives Program (FAP)

Treasury has also developed an initiative to limit the impact of foreclosure when loan modifications cannot be performed. On May 14, Treasury Secretary Geithner and HUD Secretary Donovan announced new details on the Foreclosure Alternatives Program, an additional MHA program to help homeowners facing foreclosure. Under the FAP, Treasury will provide servicers with incentives to pursue alternatives to foreclosures, such as short sales or the taking of deeds-in-lieu of foreclosure.[230] A short sale occurs when the borrower is unable to pay the mortgage and the servicer allows the borrower to sell the property at its current value, regardless of whether the sale covers the remaining balance on the mortgage. The borrower must list and actively market the home at its fair value,[231] and the sales transaction must be conducted at arm's length, with all proceeds after selling costs going towards the discounted mortgage payoff.[232] If the borrower lists and actively markets the home but is unable to sell within the agreed-upon time frame, the servicer may resort to a deed-in-lieu transaction, where the borrower voluntarily transfers ownership of the property to the servicer, so long as the title is unencumbered.[233]

Since Treasury recognizes that the MHA program will not help every at-risk homeowner or prevent all foreclosures, Treasury's primary objective for the FAP is to assist homeowners who cannot afford to remain in their homes by developing an alternative to foreclosure that results in their successful relocation to an affordable home.[234] While short sale and deed-in-lieu transactions may avoid depressing home prices in an individual neighborhood, as foreclosures do, this may be offset by the effect of putting more inventory on the broader housing market when there is already a substantial overhang.

Treasury designed the FAP to be used in those cases where the borrower is generally eligible for an MHA loan modification, such as having a loan originated before January 1, 2009, on an owner-

[229] GAO HAMP Report, *supra* note 98, at 23.
[230] MHA March Update, *supra* note 80.
[231] The servicer will independently establish both property value and the minimum acceptable net return on the property, and will notify the borrower of an acceptable list price and any permissible price reductions. The price can be determined based on one of two factors: (1) a property appraisal, or (2) one or more broker price opinions dated within 120 days of the short sale agreement. MHA May Update, *supra* note 79.
[232] MHA May Update, *supra* note 79.
[233] MHA May Update, *supra* note 79.
[234] MHA May Update, *supra* note 79.

occupied property in default, but does not qualify or is unable to maintain payments during the trial period or modification.[235] Eligible borrowers can participate until December 31, 2012. Prior to resorting to foreclosure, servicers participating in HAMP must evaluate eligible borrowers to determine if a short sale is appropriate.[236] This determination is based on a number of factors, including property condition and value, average marketing time in the community where the property is located, the condition of title including the presence of any junior liens,[237] along with the servicer's finding that the net sales proceeds of the property are anticipated to exceed its recovery through foreclosure.[238] If the servicer determines that a short sale would be appropriate, the borrower will have at least 90 days[239] to market and sell the property, using a licensed real estate professional experienced in selling properties in the vicinity.[240] No foreclosure sale can occur during the agreed-upon marketing period, provided that the borrower is making good-faith efforts to sell the property.[241] Servicers are not permitted to charge borrowers any fees for participating in the FAP.[242] Participating servicers must comply with program requirements so long as they do not conflict with contractual agreements with investors.

The FAP facilitates both short sales and deeds-in-lieu by providing incentive payments to borrowers, junior-lien holders, and servicers, similar in structure and amount to MHA incentive payments. Servicers can receive incentive compensation of up to $1,000 for each successful completion of a short sale or deed-in-lieu.[243] Borrowers are eligible for a payment of $1,500 in relocation expenses in order to effectuate short sales and deeds-in-lieu of foreclosure.[244] The short sale agreement, upon the servicer's option, may also include a condition that the borrower agrees to "deed the property to the servicer in exchange for a release from the debt if the property does not sell within the time specified in the Agreement or any extension thereof."[245] In such cases, the borrower agrees to vacate the property within 30 days and, upon performance, receives $1,500 from Treasury to assist with relocation costs.[246] Treasury has also agreed to share the cost of paying junior lien holders to release their claims by matching $1 for every $2 paid by investors, for a maximum total Treasury contribution of $1,000.[247] Payments are made upon the successful completion of a short sale or deed-in-lieu.

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[235] Secretaries Geithner, Donovan Announcement, *supra* note 78; MHA May Update, *supra* note 79.

[236] MHA May Update, *supra* note 79.

[237] For the property to be sold as a short sale or deed-in-lieu, all junior liens, mortgages or other debts against the property must be cleared, unless the servicer has a "reasonable belief" that all liens on the property can be cleared. MHA May Update, *supra* note 79.

[238] MHA May Update, *supra* note 79.

[239] There is a maximum marketing period of one year for the property in order to ensure that steps are being taken as quickly as possible to complete the short sale and deed-in-lieu process. MHA May Update, *supra* note 79.

[240] MHA May Update, *supra* note 79.

[241] MHA May Update, *supra* note 79.

[242] MHA May Update, *supra* note 79.

[243] MHA May Update, *supra* note 79.

[244] MHA March Update, *supra* note 80; MHA May Update, *supra* note 79.

[245] MHA May Update, *supra* note 79.

[246] MHA May Update, *supra* note 79. This amount is in addition to any funds the servicer may provide to the borrower.

[247] MHA May Update, *supra* note 79.

The Program also contains a streamlined process for completing short sale transactions. Treasury will provide standardized documentation, including a short sale agreement and an offer acceptance letter, which will outline marketing terms, the rights and responsibilities of all parties, and identify timeframes for performance.[248] With the use of standardized documents, Treasury expects that the complexity of these transactions will be minimized, increasing the number of short sale transactions. Other program features include limits on commission reductions.

The remaining details of the program are still being finalized, and Treasury plans to announce them once they are completed.[249] Treasury has also not announced the number of borrowers it anticipates will be assisted under FAP.

6. HOPE for Homeowners

HOPE for Homeowners is part of the Housing and Economic Recovery Act of 2008 (HERA), signed into law in July 2008.[250] It is intended to help borrowers who are having difficulty making payments on their mortgages but who can afford an FHA-insured loan by refinancing the borrower into an FHA loan.[251] The program also directly addresses the problem of underwater mortgages by requiring reduction in the principal balance of the loan.[252] Like MHA, it is a federal program, but is not part of TARP and is run through HUD, not Treasury, although it has subsequently utilized some TARP funding. Unfortunately, it has had little impact thus far.

HUD announced the original program details in October 2008. Voluntary for all participants, it requires lenders to write down the principal of the mortgage to 90 percent of the value of the property.[253] Though the original program did not provide any monetary incentives for principal reduction, a lender would avoid the expenses of foreclosure and the possibility that the home would sell for less than 90 percent of its value. Also, as discussed below, under the current program the lender will benefit from any equity

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[248] MHA May Update, *supra* note 79.

[249] House Testimony of Dave Stevens, *supra* note 71.

[250] Pub. L. No. 110–289 §§ 1401–04.

[251] The purpose of the program is:

(1) to create an FHA program, participation in which is voluntary on the part of homeowners and existing loan holders to insure refinanced loans for distressed borrowers to support long-term, sustainable homeownership; (2) to allow homeowners to avoid foreclosure by reducing the principal balance outstanding, and interest rate charged, on their mortgages; (3) to help stabilize and provide confidence in mortgage markets by bringing transparency to the value of assets based on mortgage assets; (4) to target mortgage assistance under this section to homeowners for their principal residence; (5) to enhance the administrative capacity of the FHA to carry out its expanded role under the HOPE for Homeowners Program; (6) to ensure the HOPE for Homeowners Program remains in effect only for as long as is necessary to provide stability to the housing market; and (7) to provide servicers of delinquent mortgages with additional methods and approaches to avoid foreclosure.

12 U.S.C. § 1715z–23(b). The mortgage must have been taken out prior to January 1, 2008, all information on the original mortgage must be true, and the homeowner must not have been convicted of fraud. *Id.*

[252] White House Office of Press Secretary, *President Obama Signs the Helping Families Save Their Homes Act and the Fraud Enforcement and Recovery Act* (May 20, 2009) (online at www.whitehouse.gov/the_press_office/Reforms-for-American-Homeowners-and-Consumers-President-Obama-Signs-the-Helping-Families-Save-their-Homes-Act-and-the-Fraud-Enforcement-and-Recovery-Act/); Jessica Holzer, *Dispute With Banks Continues To Dog U.S. Mortgage Relief Program*, Wall Street Journal (Sept. 23, 2009) (online at online.wsj.com/article/BT-CO-20090923-709566.html) (hereinafter "Holzer Mortgage Relief Article").

[253] U.S. Department of Housing and Urban Development, *Fact Sheet: HOPE for Homeowners to Provide Additional Mortgage Assistance to Struggling Homeowners* (accessed Oct. 6, 2009) (online at www.hud.gov/hopeforhomeowners/pressfactsheet.cfm).

created as well as future appreciation in the home. EESA amended the Housing and Economic Recovery Act, providing HUD with greater authority under the program and providing borrowers with more flexibility under the program. Revised program details were released in November 2008, aiming to "reduce the program costs for consumers and lenders alike while also expanding eligibility by driving down the borrower's monthly mortgage payments."[254] Among other things, these changes increased the LTV ratio to 96.5 percent and allowed lenders to extend the loan's term from 30 to 40 years.[255]

A unique feature of HOPE for Homeowners is that participating homeowners are required to share with FHA both the equity created at the beginning of the new mortgage and a portion of the future appreciation in the home.[256] FHA will receive 100 percent of the equity if the home is sold during the first year, and will reduce its claim by 10 percent each year until after the fifth year of the agreement, when the level settles at a 50 percent split between the FHA and the homeowner.[257] The program also requires the borrower to share any future home price appreciation with the FHA in a 50/50 split that remains constant throughout the life of the loan.[258] If there is no equity or appreciation in the home when the homeowner sells or refinances, the homeowner is not required to pay anything to FHA.[259]

The Helping Families Save Their Homes Act of 2009 further amended the program in May 2009.[260] An impetus for the amendments was the low participation in the program.[261] Senator Dodd explained that, "While the intentions for the bill were high, the reality is, the bill didn't even come close to achieving the goals those of us who crafted it thought it would."[262] This bill added two incentives for servicers to participate in the program. Prior to this, there had been no incentive written into the law for servicer participation. The Helping Families Save Their Homes Act added incentive payments to servicers. These incentive payments closely approximate MHA incentive payments.[263] The incentive payments are funded through TARP.[264]

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[254] U.S. Department of Housing and Urban Development, *Bush Administration Announces Flexibility for "HOPE for Homeowners" Program* (Nov. 19, 2008) (online at www.hud.gov/news/release.cfm?content=pr08-178.cfm).

[255] *Id.*

[256] Pub. L. No. 110–289 § 257(k). Equity sharing is a little known financing method by which a non-resident investor provides capital and receives a portion of any equity in the home. The bottom line in equity sharing is appreciation; if the home does not appreciate in value, then the non-resident investor will receive no benefit from the arrangement. *Id.*

[257] U.S. Department of Housing and Urban Development, *Basic Consumer Facts about the HOPE for Homeowners Program* (Oct. 2, 2008) (online at www.hud.gov/hopeforhomeowners/consumerfactsheet.cfm). HUD provides an example of how this will work. For a home currently worth $200,000, the mortgage would be written down to $180,000, providing the homeowner with $20,000 equity. If the homeowner sold or refinanced within one year, he or she would have to pay 100 percent of the equity received, or all $20,000, to FHA. If the home were sold or refinanced in the second year, then FHA would receive 90 percent of the equity, or $18,000. The percentages decrease by 10 percent a year, until they level out after year five at 50 percent shared.

[258] *Id.* In the example stated above, if the homeowner sold the home for $250,000 at any point in the future, FHA would receive $25,000 of the $50,000 appreciation in the home.

[259] Federal Housing Administration, *HOPE for Homeowners Equity Sharing* (accessed Oct. 6, 2009) (online at www.fha.com/hope__for__homeowners__equity.cfm).

[260] Pub. L. No. 111–22 § 202.

[261] Comments of Senator Harry Reid, *Congressional Record—Senate: S5184* (May 6, 2009).

[262] Comments of Chris Dodd, *Congressional Record—Senate: S5003* (May 1, 2009).

[263] Pub. L. No. 111–22 § 202(a)(11).

[264] Pub. L. No. 111–22 § 202(b).

Second, the appreciation-sharing structure was changed: HUD must now share with first or second lien holders the future appreciation up to the appraised value of the property when the existing loan was first issued. The portion of appreciation shared with lien holders comes out of the 50 percent FHA share.[265] The lien holders do not, however, receive a portion of the equity sharing. The appreciation sharing could be an incentive to lenders otherwise wary of writing down the principal of the loan. This compensation to second lien holders could also be crucial to the success of the program. Second lien holders are often the sticking point in mortgage modifications, and providing them with a share of future appreciation in the home could incentivize them to agree to the modification. Without direct financial incentives, lenders had limited reasons to participate in the program, as demonstrated by the lack of participation. Because the loans are underwater, junior lien holders are out of the money and only stand to gain by holding out until prices increase, absent incentives; the direct incentive payments and appreciation sharing may draw more lender interest. Allowing lenders to also participate in equity sharing could further increase lender participation.

HOPE for Homeowners was originally predicted to help 400,000 homeowners. Though it is still in effect and running concurrent to MHA, it has seen little success. It is doubtful whether this goal will be reached. By January 24, 2009, it had closed 22 loans, and had 442 applications for which the lender intended to approve the borrower for the program.[266] By September 23, 2009, only 94 loans had closed, and lenders had stated an intention to approve an additional 844 applications.[267] These numbers do not reflect the program as revised by the May 2009 amendments, as they have not yet been enacted. Though the revised program will be rolled out soon, HUD has still not reached agreement with large national banks and their regulators about how much payment will be required to extinguish second liens.[268] HUD still believes that the program will serve a "substantial niche" of borrowers, especially those with no second mortgage.[269] There is also a concern that servicers, already overwhelmed with MHA modification requests, will not be willing to complete the additional work required by HOPE for Homeowners.[270] Although HUD continues to work on the program and has plans to re-launch the program, it appears unlikely at this time that HOPE for Homeowners will play more than a minor role in providing foreclosure relief.

[265] Pub. L. No. 111–22 § 202(a)(6)(C).

[266] U.S. Department of Housing and Urban Development, *HOPE for Homeowners Program Monthly Report to Congress* (Jan. 2009) (online at portal.hud.gov/portal/page/portal/FHA__Home/lenders/h4h__monthly__reports__to__congress/H4H%20Report%20to%20Congress%20January.pdf). Although HUD is statutorily required to submit monthly reports to Congress on the progress of the program, January 2009 appears to be the latest report available. *Id.*

[267] Holzer Mortgage Relief Article, *supra* note 252.

[268] Holzer Mortgage Relief Article, *supra* note 252.

[269] Holzer Mortgage Relief Article, *supra* note 252.

[270] Holzer Mortgage Relief Article, *supra* note 252; Statistics provided by U.S. Department of Housing and Urban Development to the Panel. Interestingly, since June 2009, there are no applications which lenders have announced an intention to approve. This could be because lenders are waiting for formal implementation of the May amendments to the program.

7. Other Federal Efforts Outside of TARP

While the federal government's primary foreclosure mitigation efforts are embodied in MHA or otherwise linked to the MHA program through TARP funding, there are other complementary federal efforts. The Federal Deposit Insurance Corporation (FDIC) has established a loan modification program that is a mandatory component of all FDIC residential mortgage loss-sharing agreements with purchasers of failed banks' assets.[271] Between January 2008 and early September 2009, the FDIC entered into 53 such loss-sharing agreements,[272] which cover potential losses on more than $50 billion in loans, including both residential and commercial mortgages.[273] Many of the loss-sharing deals involve loans that were originated by small banks that have since failed; however, some of the loans were made by larger lenders, including IndyMac and Downey Savings and Loan.[274] Under the FDIC Mortgage Loan Modification Program, delinquent borrowers who received mortgages from those failed banks may be eligible for a modification.

The FDIC's program is generally quite similar to HAMP. Both programs apply to residential mortgages that are more than 60 days delinquent. Both use an NPV test to determine the estimated difference between the amount the lender would earn from a foreclosure sale versus the amount that a loan modification would yield. Both programs use standardized methods—reducing interest rates, extending the term of the loan, and forbearing principal—to reduce borrowers' mortgage payments in order to decrease their debt-to-income ratio.[275] Not all of the details of the two programs are the same, though. For instance, HAMP allows interest rates to be reduced to as low as 2 percent, while the lowest interest rate that can be charged under the FDIC program is 3 percent.[276] Also, while the FDIC has released the model that it uses to calculate net present value, Treasury has not publicly released its NPV model for HAMP, a decision that has drawn criticism from some homeowner advocates.[277]

In September 2009, the FDIC, as part of its loan modification program, made an effort to address the tide of foreclosures caused by rising unemployment. The agency said that it was encouraging banks with which it has entered loss-sharing agreements to consider a temporary forbearance plan of at least six months for borrowers whose default is primarily due to unemployment or underemployment. "With more Americans suffering through unemployment or cuts in their paychecks, we believe it is crucial to offer a

[271] Loss sharing agreements allow the FDIC to sell loans that otherwise would be difficult if not impossible to unload. Under these agreements, the FDIC agrees to cover 80 percent of the acquiring bank's losses on certain loans that it buys, up to a specified limit. On losses above the limit, the FDIC agrees to cover 95 percent of the acquiring bank's losses.

[272] Tami Luhby, *FDIC Pushes Mortgage Help for Jobless*, CNNMoney.com (Sept. 11, 2009) (online at money.cnn.com/2009/09/11/news/economy/forbearance_unemployment/index.htm).

[273] Federal Deposit Insurance Corporation discussions with Panel staff, Sept. 10, 2009.

[274] Binyamin Applebaum, *FDIC Seizes Three Banks, Expanding Loan-Relief Effort*, Washington Post (Nov. 22, 2008) (online at www.washingtonpost.com/wp-dyn/content/article/2008/11/21/AR2008112104099.html).

[275] Federal Deposit Insurance Corporation, *FDIC Loan Modification Program* (online at www.fdic.gov/consumers/loans/loanmod/FDICLoanMod.pdf) (accessed Oct. 6, 2009).

[276] *Id.*

[277] Alexandra Andrews & Emily Witt, *The Secret Test That Ensures Lenders Win On Loan Mods*, ProPublica (Sept. 15, 2009) (online at www.propublica.org/ion/bailout/the-secret-test-that-ensures-lenders-win-on-loan-mods–915).

helping hand to avoid unnecessary and costly foreclosures," FDIC Chairman Sheila Bair said in a statement. "This is simply good business since foreclosure rarely benefits lenders and would cost the FDIC more money, not less."[278]

It is not clear whether the FDIC's loan modification program has been successful. The FDIC has yet to release data on the number of loans covered by its loan modification program; the number of modification offers that have been made to borrowers; or the number of loans modified. FDIC has told the Panel that it is compiling the data. Once the data are released, it should be possible to compare the modification rates under the FDIC program with similar programs, such as HAMP.

8. State/Local/Private Sector Initiatives

a. State Law Governs the Foreclosure Process

In addition to the federal foreclosure mitigation efforts, a number of state, local, and private sector initiatives are supplementing federal efforts. State law continues for the most part to determine when and how an individual can be subject to foreclosure. Mediation, counseling, and outreach efforts at the state and local levels are growing because of the mortgage crisis.

State foreclosure laws vary, in many cases widely.[279] Many predate the residential mortgage industry, let alone the enormous changes that began in the 1980s.[280] There are both judicial and non-judicial (often called "power-of-sale") foreclosure states.[281] Judicial foreclosure requires a lender to obtain court authority to sell a home. The lender must prove that the mortgage is in default, and the borrower can put forward any defenses he or she has; the court may also try to foster a settlement. If the foreclosure goes forward, the proceeds from sale of the property go first to satisfy the outstanding mortgage balance.

In a non-judicial foreclosure, a lender simply declares a homeowner in default and provides him or her with a notice of default and intent to sell the property. Most states treat a completed sale as final,[282] so that the homeowner's only chance to assert any claims and defenses is to ask a court to stop the sale before it occurs; the financial and sometimes emotional condition of the bor-

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[278] Federal Deposit Insurance Corporation, *FDIC Encourages Loss-Share Partners to Provide Forbearance to Unemployed Borrowers* (Sept. 11, 2009) (online at www.fdic.gov/news/news/press/2009/pr09167.html).

[279] John Rao & Geoff Walsh, *Foreclosing a Dream: State Laws Deprive Homeowners of Basic Protections*, National Consumer Law Center, at 3 (Feb. 2009) (online at www.consumerlaw.org/issues/foreclosure/content/FORE-Report0209.pdf). A state's foreclosure process is usually laid out in its civil code. Local variations, however, may exist; for example, a locality might modify the state rules about the time period allowed for parts of the process, the manner and places for publication of foreclosure notices, and the location of sales of foreclosed property. *Id.*

[280] *Id.* at 8.

[281] Some states permit both, and in many cases non-judicial procedures include at least the due process rights contained in the judicial foreclosure process. In 18 states, mortgages are most commonly foreclosed by judicial action. The majority of foreclosures occur through judicial procedures, and in 32 states plus the District of Columbia, the majority of foreclosures occur through non-judicial procedure. Id. at 12–13. See also an appendix to the same report, *Survey of State Foreclosure Laws*, National Consumer Law Center (Feb. 2009) (online at www.consumerlaw.org/issues/foreclosure/content/Foreclosure-Report-Card-Survey0209.pdf).

[282] In states that do not regard either judicial or non-judicial foreclosure sales as immediately final, borrowers may have a certain period to repurchase the property for the amount owed and the sale only becomes final when that "redemption" period ends.

rower, and his or her potential unfamiliarity with the legal system, may effectively limit that option.

States with judicial foreclosures can adopt or enforce stricter burdens of proof for parties bringing foreclosure actions. For example, if a lender cannot prove ownership of the property, then it cannot foreclose on a residence. Requiring mortgagees to provide the original paperwork would do more than satisfy a legal technicality; it would often have practical consequences. One 2007 study of more than 1,700 bankruptcy cases involving home foreclosures found that the note was missing in 41.1 percent of the cases.[283] And without the mortgage note and other key documents, it can be difficult to assess the accuracy of the mortgagee's calculation of the amount of debt owed. Disputes over these calculations are common. As the same 2007 study noted, "Without documentation, parties cannot verify that the claim is correctly calculated and that it reflects only the amounts due under the terms of the note and mortgage and permitted by other applicable law." [284]

b. Innovative Approaches by States, Localities, and the Private Sector

Moratoria. Many states responded to the rise in foreclosures during the Great Depression by imposing temporary moratoria on both farm and nonfarm residential mortgage foreclosures.[285] Such moratoria were subsequently upheld by the Supreme Court.[286] With the number of foreclosures currently on the rise, many states are revisiting this concept.[287] Proponents of moratoria argue that they provide an incentive to make modifications by closing off the possibility of a foreclosure for a long enough period of time that lenders

[283] Porter Bankruptcy Mortgage Claims, *supra* note 173, at 127, 147.

[284] Porter Bankruptcy Mortgage Claims, *supra* note 173, at 146.

[285] Starting in February 1933 and continuing over the subsequent eighteen months, twenty-seven states imposed moratoria to help address the number of mortgage foreclosures. These states included Arizona, Arkansas, California, Delaware, Idaho, Illinois, Iowa, Kansas, Louisiana, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Hampshire, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Vermont, and Wisconsin. Other states made permanent changes to state laws governing foreclosure by limiting the rights or incentives of lenders to foreclose on mortgaged property. David C. Wheelock, *Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression*, Federal Reserve Bank of St. Louis Review, at 573–75 (Nov./Dec. 2008).

[286] The statute was upheld by the United States Supreme Court in a 5–4 vote in *Home Building & Loan Association* v. *Blaisdell*, 290 U.S. 398 (1934). The *Blaisdell* decision has never been explicitly overruled, and the decision has set the stage for current and future mortgage moratoria.

[287] In April 2007, Massachusetts enacted a 30–60 day foreclosure moratorium. In August 2008, New York enacted similar legislation requiring lenders to notify borrowers in writing at least 90 days before commencing a foreclosure action. In North Carolina, Gov. Beverly E. Perdue signed a bill into law on September 6 that allows a court clerk to postpone a foreclosure hearing for up to 60 days in order to provide homeowners with additional time to work out a payment plan with their mortgage holder and remain in their home. This legislation goes into law on October 1. Additionally, on February 20, 2009, California Gov. Arnold Schwarzenegger signed a bill placing a 90–day moratorium on some, but not all, foreclosures of California homes purchased between January 1, 2003 and January 1, 2008. It went into effect in late May. Current moratoria, such as these examples, are generally short-term, especially as compared to the 1933 Minnesota statute's two-year moratorium.

Compared with other states, Maryland's foreclosure prevention measures have been forceful. In April 2008 Maryland instituted a law that requires a 90–day period after default before lenders can file a foreclosure action, plus a 45–day period between notice of a foreclosure and a sale of the property. Maryland also requires servicers to report data related to their loan modifications to the state; to provide the state with lists of homeowners with adjustable rate mortgages that will soon reset (to permit targeted outreach efforts to those individuals); and to respond promptly to homeowners and pursue loss mitigation where possible.

and servicers will consider other options,[288] while opponents counter that delaying foreclosures simply extends the crisis and postpones the eventual day of reckoning.[289]

Mediation. A borrower and a lender cannot modify a mortgage without consultation. But servicers are often not equipped to handle the volume of calls they receive. Borrowers complain that servicers ignore them and that, even when they reach someone, repeated requests for the same information produce only silence. When they cannot reach a servicer or call repeatedly and no one can help, borrowers may give up in frustration, while the servicers may list the borrower as non-responsive. In other cases, however, borrowers do not even try to have their mortgages modified, often because they feel financially or emotionally overwhelmed.[290]

States have increasingly turned to mediation—the use of a neutral third party to create a dialogue between lender and borrower—to overcome these obstacles.[291] Mandatory mediation programs require both the lender and borrower to participate; in voluntary programs mediation is triggered only if the borrower chooses. There is a growing consensus that mandatory programs are more effective.[292]

The Philadelphia mediation program was featured at the Panel's foreclosure mitigation field hearing. In April 2008,[293] the Philadel-

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[288] Jim Siegel, *Ohio House Panel Passes Foreclosure Moratorium*, Columbus Dispatch (May 13, 2009) (online at www.dispatchpolitics.com/live/content/local__news/stories/2009/05/13/copy/noforeclosure.ART__ART__05–13–09__B1__ITDRI8L.html?adsec=politics&sid=101).

[289] Jeremy Burgess, *Effects of the Foreclosure Moratorium in Wayne County*, Urban Detroit Wholesalers LLC (Feb. 9, 2009) (online at www.urbandetroitonline.com/detroit-real-estate/foreclosure-moratorium-wayne-county/).

[290] Florida Supreme Court Task Force on Residential Mortgage Foreclosure Crisis, *Final Report and Recommendations on Residential Mortgage Foreclosure Cases*, at 27 (Aug. 17, 2009) (online at www.floridasupremecourt.org/pub__info/documents/Filed__08–17–2009__Foreclosure__Final__Report.pdf).

[291] In New York, mandatory settlement conferences have been instituted for high-cost, subprime and non-traditional home loans. In New Jersey, the courts have established mandatory mediation for all cases in which owner-occupants of homes contest foreclosure actions. In Maine, a pilot project has been established in York County, under which mediation is triggered in foreclosure cases where the owner-occupant responds to the lender's complaint. The program is expected to be expanded across the entire state in January. In North Carolina, a new law requires lenders to describe the efforts they made to resolve the case voluntarily prior to the foreclosure proceeding. And voluntary mediation programs have been established in Ohio and Nevada, one of the states most battered by foreclosures. State of New York Banking Dept., *Help for Homeowners Facing Foreclosure* (online at www.banking.state.ny.us/hetp.htm) (accessed October 8, 2009); New Jersey Judiciary, *Judiciary Announces Foreclosure Mediation Program to Assist Homeowners at Risk of Losing Their Homes* (Oct. 16, 2008) (online at www.judiciary.state.nj.us/pressrel/pr081016c.htm); Maine Judicial Branch, Homeowner Frequently Asked Questions (online at www.courts.state.me.us/court__info/services/foreclosure/home__faq.html) (accessed Oct. 6, 2009); Maine Judicial Branch, Foreclosure Diversion Project—York County Program Pilot Project (online at www.courts.state.me.us/court__info/services/foreclosure/index.html) (accessed Oct. 6, 2009); Andrew Jakabovics & Alon Cohen, *It's Time We Talked: Mandatory Mediation in the Foreclosure Process*, Center for American Progress, at 42 (June 2009) (online at www.americanprogress.org/issues/2009/06/pdf/foreclosure__mediation.pdf); General Assembly of North Carolina, Session Law 2009–573 (online at www.ncga.state.nc.us/Sessions/2009/Bills/Senate/PDF/S974v5.pdf); The Supreme Court of Ohio & The Ohio Judicial System, Foreclosure Mediation Resources (online at www.supremecourtofohio.gov/JCS/disputeResolution/foreclosure/default.asp) (accessed Oct. 6, 2009); Supreme Court of Nevada, *First Two Mediations Scheduled in Foreclosure Mediation Program* (Aug. 25, 2009) (online at www.nevadajudiciary.us/index.php/foreclosure-mediation/471–first-two-mediations-scheduled-in-foreclosure-mediation-program.html).

[292] In June 2008, the Connecticut legislature established a statewide voluntary mediation program covering all one- to four-unit owner-occupied properties. The program was initially voluntary; in its first nine months only 34 percent of eligible borrowers chose mediation but they were successful almost 60 percent of the time. The results led the legislature to act this year to require participation by borrowers.

[293] Council of the City of Philadelphia, Resolution No. 080331 (March 27, 2008) (online at webapps.phila.gov/council/attachments/5009.pdf).

phia courts created a Residential Mortgage Foreclosure Diversion Pilot Program, which required "conciliation conferences" in all foreclosure cases involving residential properties with up to four units that were used as the owner's primary residence. The idea is that bringing borrowers into the same room with lenders' representatives will foster a compromise that is in both parties' best interests. As Judge Annette Rizzo, the program's Philadelphia architect, said in written testimony submitted at the Panel's foreclosure mitigation field hearing, "[o]ur Program is all about the face-to-face between the lender and borrower." [294] The Philadelphia program has been hailed as a potential model for how to deal with the foreclosure crisis in other localities. And while officials in Philadelphia acknowledge a need to collect more data,[295] preliminary statistics indicate that Philadelphia is having an unusually high level of success at averting foreclosures. Since the program began, 25 percent of all homes in the program have been saved from foreclosure, while another 48 percent of cases are waiting for resolution as negotiations between the two parties continue.[296] Officials in Philadelphia say the active involvement of the local community has been an important part of the program's success. This includes the efforts of mediators and lawyers who have donated their time, as well as community groups that have canvassed neighborhoods to ensure that distressed homeowners are aware of the services that are available to them.[297]

While state foreclosure mediation programs have the potential to play an important role in preventing foreclosures and in ensuring that homeowners receive the benefits of HAMP, they have not been able to stem the full tide of foreclosures. Many of the existing programs have been found to leave too much discretion in the hands of the servicers and fail to impose meaningful obligations on servicers to modify loans.[298]

Counseling. Borrowers are often intimidated to speak directly with a lender or have difficulty when they attempt such contact. Housing counselors offer borrowers advice and an understanding of their options. Forty states have adopted counseling programs or appropriated funds for counseling programs.

Outreach. No program can succeed if homeowners do not know about it, so strong public outreach efforts are essential. At least 17 state and local governments have established toll-free foreclosure hotlines that refer callers to trained housing counselors.[299] At least

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[294] Congressional Oversight Panel, Written Testimony of Judge Annette Rizzo, Court of Common Pleas, First Judicial District, Philadelphia County, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 4 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony–092409–rizzo.pdf).

[295] *Id.* at 90–91.

[296] *Id.* at 8.

[297] *Id.* Congressional Oversight Panel, Written Testimony of Philadelphia Legal Assistance Supervising Attorney, Consumer Housing Unit, Irwin Trauss, *Philadelphia Field Hearing on Mortgage Foreclosures* (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony–092409–trauss.pdf) (hereinafter "Trauss Philadelphia Hearing Written Testimony").

[298] National Consumer Law Center, *State and Local Foreclosure Mediation Programs: Can They Save Homes?* (Sept. 2009) (online at www.consumerlaw.org/issues/foreclosure_mediation/content/ReportS-Sept09.pdf).

[299] For example, Colorado, which had the nation's fifth-highest foreclosure rate in 2008, has created one of the nation's strongest outreach efforts. It includes (1) a toll-free telephone line sponsored by state agencies, non-profit groups, lenders, and other private sector businesses; (2) English- and Spanish-language television, radio, and print public service announcements; and (3) a web campaign that makes use of YouTube and Twitter. Between October 2006 and March 2008, the Colorado hotline received 33,250 calls, which in turn produced 8,000 counseling ses-

32 states have created websites to inform the public about the available assistance programs.[300]

The Pew Center on the States found that, as of 2008, 11 states and the District of Columbia did not offer housing counseling,[301] and six states offered no foreclosure prevention services at all.[302] The private sector HOPE NOW alliance among housing counselors, mortgage companies, investors, and other participants in the mortgage market works to increase outreach efforts nationwide, putting financially distressed individuals in touch with 22 different counseling agencies across the country, but its efforts are especially important in areas that lack other options. The volume of cases with which the alliance and its linked agencies have dealt rose from 60,000 monthly in July 2007 to roughly 150,000 in July 2009.[303] Subprime loan work-out plans have steadily increased as well, from 80,000 in July 2007 to 100,000 in July 2009.[304]

Temporary Financing Programs. The current foreclosure prevention efforts at the federal level do not specifically target delinquencies caused by unemployment, despite evidence that many of today's foreclosures are the result of a sudden decline in income.[305] However, the state of Pennsylvania does run a program that provides a safety valve for homeowners who have been laid off. Since 1983, the state has been operating an emergency loan program for people who have lost their jobs or been negatively impacted by another life event, such as illness or divorce, and are subsequently unable to make their mortgage payments. Pennsylvania's Homeowners' Emergency Mortgage Assistance Program (HEMAP) offers mortgage relief for as long as two years or for as much as $60,000.

The program helps not only people who are currently unemployed, but also those who fell behind on their mortgage payments during an earlier period of unemployment. Loan recipients who currently have jobs are required to pay up to 40 percent of their net monthly income toward their housing expenses,[306] while loans to people who are currently jobless do not accrue interest until their income is restored.[307] As part of the loan agreement, the Pennsylvania Housing Finance Agency, which runs the program,

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sions by the end of 2007; 67 percent of those who received mortgage counseling were able to stay in their homes, at least initially, 13 percent gave up their homes voluntarily, and 20 percent were unable to avoid foreclosure.

[300] National Governors Association Center for Best Practices, *Foreclosure Mitigation: Outreach* (July 29, 2009) (online at www.nga.org/portal/site/nga/menuitem. 9123e83a1f6786440ddcbeeb 501010a0/?vgnextoid= d02e19091b68f110VgnVCM1 000005e00100aRCRD).

[301] The 11 states were Alabama, Arkansas, Hawaii, Kansas, New Hampshire, North Dakota, Texas, Utah, Washington, West Virginia, and Wyoming. Pew Defaulting on the Dream Article, *supra* note 10.

[302] The six states, all of which had no state-funded refinance program, no loan modification program, no effort to prevent rescue scams and mortgage fraud, and no housing counseling available, were Alabama, Arkansas, Kansas, North Dakota, West Virginia, and Wyoming. Pew Defaulting on the Dream Article, *supra* note 10.

[303] HOPE Now, *Phase 1National Data: July 2007 to July 2009* (online at www.hopenow.com/industry-data/Summary%20Charts%20Jul%202009%20v2.pdf) (accessed Oct. 6, 2009).

[304] *Id.*

[305] Congressional Oversight Panel, Testimony of Federal Reserve Bank of Boston Senior Economist and Policy Advisor, Research Department, Dr. Paul Willen, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 109–110 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony–092409-willen.pdf) (hereinafter "Willen Philadelphia Hearing Written Testimony").

[306] Pennsylvania Housing Finance Agency, *Pennsylvania Foreclosure Prevention Act 91 of 1983—Homeowners' Emergency Mortgage Assistance Program* (HEMAP) (online at www.phfa.org/consumers/homeowners/hemap.aspx) (accessed Oct. 6, 2009).

[307] Trauss Philadelphia Hearing Written Testimony, at 3, *supra* note 297, at 10.

takes a junior lien on the property.[308] Since the program was established, HEMAP has actually earned money for the state of Pennsylvania, and witnesses at the Panel's field hearing in Philadelphia endorsed it as a model that should be considered at the national level.[309] The fact that state governments are currently strapped financially means that this kind of temporary assistance program is likely to need federal support.

D. Big Picture Issues

1. Purpose of Foreclosure Mitigation

In the previous sections, the Panel has evaluated foreclosure mitigation programs on their own terms. While it is important to evaluate the progress of the federal foreclosure mitigation programs in meeting their stated goals, it is equally important to analyze the adequacy of those goals in addressing the underlying foreclosure problem. Most programs are designed to prevent foreclosures in specific circumstances, but however successful programs might be on their own terms, they must ultimately be judged on whether they succeed in implementing major policy goals. Evaluating foreclosure mitigation programs in this manner first necessitates a determination of the ultimate purpose of foreclosure mitigation programs.

A central purpose of foreclosure prevention efforts is to protect the economy from the systemic consequences of home foreclosures. Congress recognized as much when it declared the protection of home values and the preservation of homeownership one of the purposes of the EESA.[310]

Foreclosure prevention efforts help preserve homeownership and stabilize the housing market, which protects home values. Stabilization of the housing market is also critical to overall economic recovery. 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.

Housing markets have achieved some degree of stability through massive federal support. The Federal Reserve's monetary policy has produced low interest rates, which have stimulated greater demand for mortgage-financed home purchases by lowering the cost of capital, and federal government support for the GSEs and the private-label MBS market has also contributed to liquidity and thus lower costs of mortgage capital. This level of support cannot continue indefinitely, however, and as long as foreclosure and real estate owned (REO) inventory flood the housing market and contribute to an oversupply of housing stock for sale, there will be strong downward pressure on home prices.

In these circumstances, volume and speed of foreclosure prevention assistance are critical if there is to be sufficient systemic impact. The key metric for evaluating foreclosure prevention efforts overall is thus whether a sufficient number of foreclosures are pre-

[308] Pennsylvania Housing Finance Agency, *Homeowners' Emergency Mortgage Assistance Program (HEMAP)—FAQ* (online at www.phfa.org/hsgresources/faq.aspx#hemap—q13) (accessed Oct. 7, 2009).
[309] Trauss Philadelphia Hearing Written Testimony, at 3, *supra* note 297, at 10.
[310] Pub. L. No. 110–343 § 2(2)(A)–(B).

vented—and not merely delayed—to allow for a stable housing market when interest rate and secondary market support are withdrawn.

Some have argued that attention and resources should be devoted to a type of moral sorting to determine who is deserving of government foreclosure prevention assistance. Devoting attention and resources to moral sorting is at odds with the goal of maximizing the macroeconomic impact of foreclosure prevention. Trying to sort out the deserving from the undeserving on any sort of moral criteria means that foreclosure prevention efforts will be delayed and have a narrower scope. Moreover, in other cases where the federal government extended assistance under TARP—such as to banks and auto manufacturers—no attempt was made to sort between entities deserving and not deserving assistance. No inquiry was made as to which investors in these entities knowingly and willingly assumed the risks of the entities' insolvency.

Accordingly, the Panel must consider whether federal foreclosure mitigation programs have sufficient scope to deal with the crisis in macroeconomic terms, whether the programs will produce long-term mortgage stability and sustainability, and the costs and benefits of the programs. The Panel recognizes that some of the foreclosure prevention programs, like MHA, are relatively new, having been in place for only six months. Other programs, however, like HOPE for Homeowners, have been in place for over a year. In all cases, however, there is now sufficient data to evaluate progress thus far, draw preliminary conclusions, and make preliminary recommendations. The Panel intends to continue to evaluate progress and make recommendations as the programs evolve.

2. Scale of Programs

Are federal foreclosure mitigation initiatives sufficient for responding to the scope of the foreclosure crisis? While recognizing the relatively early nature of many of the programs, the Panel has serious doubts in this regard. HOPE for Homeowners was predicted to help 400,000 homeowners.[311] Four to five million homeowners are eligible for HARP refinancings to achieve more affordable payments.[312] For HAMP, Treasury aims to reach three to four million loans.[313] If these goals are achieved, the Federal foreclosure mitigation initiative might help as many as 9.5 million families reduce their mortgage payments to affordable levels, including preventing 3–4 million foreclosures, a substantial share of the 8.1 million predicted by 2012.[314] It is difficult to say, however, whether that would be enough, because the Panel does not know how many foreclosures must be prevented to stabilize the housing market. How-

[311] House Committee on Financial Services, Testimony of Director of Office of Single Family Program Development, Meg Burns, *Promoting Bank Liquidity and Lending Through Deposit Insurance, HOPE for Homeowners, and other Enhancements*, 111th Cong., at 2 (Feb. 3, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs_dem/burns020309.pdf).

[312] MHA March Update, *supra* note 80.

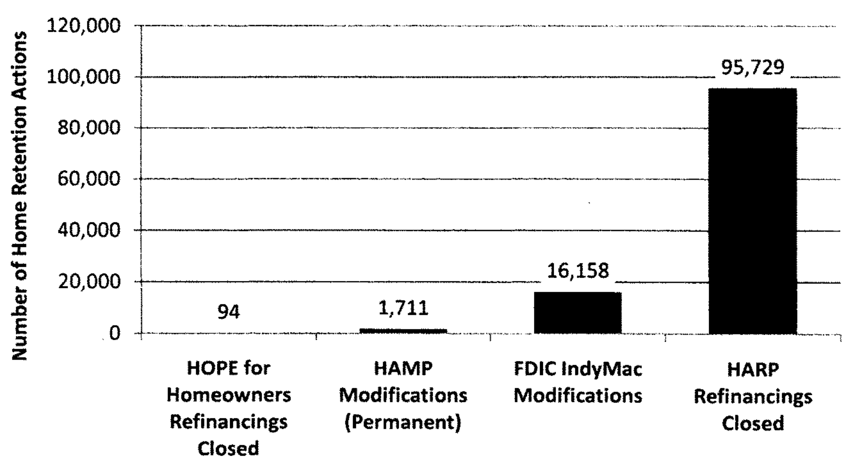
[313] MHA March Update , supra note 80. GAO has questioned whether this projection may be overstated due to some of the assumptions made in its calculation. GAO HAMP Report, *supra* note 98.

[314] Rod Dubitsky, Larry Yang, Stevan Stevanovic, and Thomas Suehr, *Foreclosure Update: Over 8 Million Foreclosures Expected*, Credit Suisse (Dec. 8, 2008) (online at www.nhc.org/Credit%20Suisse%20Update%2004%20Dec%2008.doc).

ever, if these programs achieve their maximum potential, it would undeniably be a substantial step in the right direction.

Unfortunately, there may be reason to doubt whether these programs will ever achieve Treasury's numeric goals, but it is still premature to make that judgment. HOPE for Homeowners has met with minimal interest. As of September 23, 2009, only 94 refinancings had closed, and lenders had stated they intend to approve an additional 844 applications.[315] For HARP, there have been 95,729 refinancings as of September 1, 2009. And for HAMP, there have been 571,354 cumulative trial modification offers extended, 362,348 HAMP trial modifications in progress and 1,711 permanent modifications. (See Figure 27.)

Figure 27: Total Permanent Federal Home Retention Actions by Program[316]



HOPE for Homeowners' performance has been so weak that the HUD Secretary stated that it is "tough to use."[317] Treasury officials have made no statements on the success of HARP but they are optimistic about HAMP. Based on the number of trial modifications started, Treasury has declared that HAMP is "on pace" to meet its self-set goal of 500,000 cumulative trial modifications by November 1, 2009.

While HAMP will likely achieve this more immediate goal, the achievement is relatively small in relation to the magnitude of the foreclosure crisis.

Trial modifications are a poor metric for evaluating the success of HAMP. Not all trial modifications will become permanent modifications. The roll rate from trial modifications to permanent modifications is currently 1.26 percent, meaning that of all trial modifications started at least three months ago, only 1.26 percent have converted to permanent modifications. As noted above, however, this is a very preliminary statistic that should be interpreted with

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[315] Holzer Mortgage Relief Article, *supra* note 252.
[316] Treasury Mortgage Marked Data, *supra* note 111.
[317] Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages A Failure,* Washington Post (Dec. 17, 2008) (online at www.washingtonpost.com/wp-dyn/content/article/2008/12/16/AR2008121603177.html).

caution. Additionally, Treasury has provided a two-month extension during the program ramp-up.

Once modifications become permanent, however, they must still be sustained in order to have an impact on foreclosure prevention. There will be redefaults on HAMP-modified loans. Treasury has refused to make public its redefault assumptions, but other government entities have anticipated a redefault rate of approximately 40 percent in their modification programs. The time period for Treasury's undisclosed redefault assumption is important. Should it only cover the first five years of the loan, it would not account for the increases in interest rates and thus monthly payments that kick in for HAMP-modified loans starting in year six. Similarly, the LTV assumption for Treasury's undisclosed redefault assumption is important. If Treasury's redefault assumption was created at the beginning of HAMP in winter 2009, it might assume LTVs that are substantially lower than present, which could mean that it underestimates probable redefaults. The Panel underscores that redefault assumptions are data that should be public to ensure the transparency of MHA, and are critical to the Panel's ability to provide meaningful program evaluation and oversight.

Redefaults mean that foreclosures have been delayed, rather than prevented. Therefore, the net impact of HAMP is best measured by the number of permanent modifications that are sustainable, rather than trial modifications. The Panel intends to monitor carefully the permanent modifications produced by the program over the coming months as the program begins to produce a longer track record.

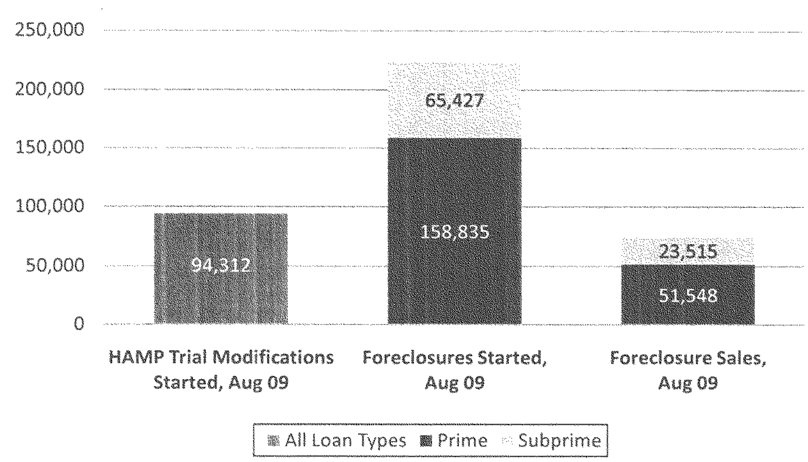
Using permanent modifications as the metric, HAMP's performance to date is weak. Six months into the program, there have only been 1,711 permanent modifications. This number is low in part because it depends on the number of trial modifications, and the initial volume of HAMP trial modifications was quite low. The Panel is concerned about the low rate of conversion from trial to permanent modifications, but is hopeful that the conversion rate will increase substantially; unless it does, HAMP will come nowhere close to keeping up with foreclosures.

Even using trial modifications as the metric, however, HAMP's broader effectiveness is in doubt. The country is on pace to see a significant number of foreclosures this year, and with rising unemployment, widespread deep negative equity, and recasts on payment-option ARMs and interest-only mortgages increasing in volume, there is no sign of the foreclosure crisis letting up. As Figure 28 shows, there were 224,262 foreclosures started in August 2009. The same month only 94,312 trial modifications were begun, a shortfall of nearly 130,000. HAMP trial modifications failed to even keep up with the number of foreclosures started on prime mortgages. Cumulatively, from March through August, there were 5 foreclosures started and 1.5 foreclosures completed for every trial modification. HAMP modifications started slowly, however, and have grown in volume every month. Thus in August 2009, there were 2.38 foreclosure starts per trial modification, and trial modifications outpaced completed foreclosure sales, with 1.25 trial modifications per completed foreclosure sale. While this is cause for some measured optimism, unless August trial modifications convert to permanent modifications at a rate of 80 percent, a far cry from current conversion rates, permanent modifications will not keep pace with completed foreclosure sales.

A permanent modification, however, must be sustainable, if it is to prevent a foreclosure. If permanent modifications redefault at a rate of 40 percent, the rate used by the FDIC's very similar modification program at Indy Mac, however, then even if 100 percent of trial modifications successfully converted to permanent modifications, there would still be a substantial shortfall relative to completed foreclosure sales.

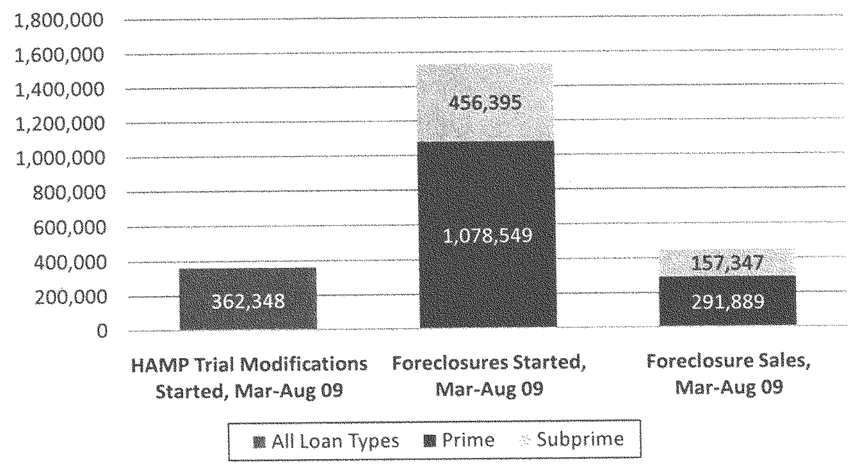
There is also reason to expect the number of HAMP trial modifications per month to drop; servicers may initially move to modify the easiest surest cases, and the most motivated and organized homeowners are likely to be among the earlier applicants. Further, because unemployment usually leaves a borrower with insufficient income to be eligible for a HAMP modification, the number of financially distressed homeowners who will be HAMP-eligible is likely to decline.

Figure 28: HAMP Modifications Compared with Foreclosure Starts and Sales, August 2009[318]



[318] Servicer Performance Report, *supra* note 95; HOPE NOW, Workout Plans and Foreclosure Sales, *supra* note 2.

Figure 29: HAMP Modifications Compared with Foreclosure Starts and Completed Foreclosure Sales, March-August, 2009[319]



The discussion of sufficiency of HAMP modification volume ultimately hinges on the question of how many foreclosures must be prevented to stabilize the housing market. This is a question to which the Panel does not have an answer, but the existing federal foreclosure prevention programs appear unlikely to have a comprehensive, or even substantial impact, and this makes it unlikely that they will succeed in macroeconomic stabilization. Clearly these programs are better than doing nothing, and for some families they will be a lifeline. These programs may well prevent the housing market from continuing a rapid decline, and that is an important accomplishment. But as the following section discusses, it is far from clear whether they will result in long-term housing market stability or whether new programs may be needed. Unless that is accomplished, the programs' success will be limited.

3. Sustainability of Modifications and Refinancings

a. Negative Equity

While HAMP modifications and HARP refinancings are able to improve the affordability of mortgages, the programs were not designed to address negative equity, which raises concerns about the sustainability of the modifications and refinancings.

HARP permits homeowners with negative equity to refinance their mortgages into more affordable and sustainable mortgage structures. The homeowner continues to have negative equity after the refinancing. Similarly, many HAMP modifications continue to have negative equity. While HAMP permits servicers to forgive principal, it does not require it, and relatively few modifications have involved principal forgiveness. The LTV of permanent HAMP modifications indicates that most are deeply underwater even post-

319 Servicer Performance Report, *supra* note 95; HOPE NOW, Workout Plans and Foreclosure Sales, *supra* note 2.

modification. More modifications have involved principal forbearance, but forbearance does not undo negative equity. Instead, it tacks on a balloon payment of forborne principal at the end of the mortgage. If housing prices appreciate significantly, homeowners with forborne principal may be able to refinance and avoid a balloon payment, but that is very much dependent on an uncertain housing market and the ability to avoid redefault until that point.

HAMP and HARP are premised upon a belief that if monthly mortgage payments are affordable, borrowers will be less likely to default, even if they are mired in negative equity. However, the impact of negative equity is not clearly understood. As the Panel has previously observed, and has since been confirmed by additional studies,[320] negative equity has a higher correlation with default than any other factor that has been identified other than affordability, which causes default. While this does not prove a causal relationship, it is also consistent with one.

Generally, negative equity has been presumed to be a necessary, but not sufficient condition for foreclosure; in addition to negative equity, there needed to be some factor making payments unaffordable, as homeowners would usually prefer to retain their home. Thus, in the New England economic downturn during the late 1980s and early 1990s, negative equity alone rarely resulted in foreclosures.[321]

Yet a more recent study has cast doubt on this conventional wisdom. A 2009 working paper by the staff of the Federal Reserve Bank of Richmond has found that negative equity alone does result in significantly higher default rates when mortgages are non-recourse.[322] Massachusetts is a recourse mortgage state, which limits the ability to extrapolate nationally from the situation in Massachusetts in the late 1980s and early 1990s.

It is also not clear to what degree the current foreclosure crisis will follow historical patterns. The housing bust in Massachusetts was not nearly as severe as the current one. In Massachusetts, housing prices fell 22.7 percent from peak. Nationally, housing prices have fallen 33 percent from peak in the current downturn, while in some regions the price declines have been much sharper—54 percent from peak in Las Vegas and Phoenix. If homeowners are more likely to wait out milder negative equity, then negative equity will likely have a stronger impact than in Massachusetts in the early 1990s.

There are two categories of negative equity defaults—strategic and necessitated. Strategic defaults by homeowners with negative equity—moving to a cheaper equivalent rental property nearby rather than continuing to make more expensive monthly mortgage payments—have been the stereotyped focus of negative equity de-

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

[321] Christopher L. Foote, Kristopher Gerardi, & Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence,* 64 Journal of Urban Economics 234 (Sept. 2008) (abstract online at ideas.repec.org/a/eee/juecon/v64y2008i2p234–245.html) (examining foreclosures in Massachusetts in 1990s).

[322] States with nonrecourse mortgages do not allow lenders to recover from other assets of the defaulted borrower, besides the home. Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from the United States,* Federal Reserve Bank of Richmond Working Paper 09–10 (online at ssrn.com/abstract=1432437) (accessed Oct. 7, 2009).

faults, and in the short term they have predominated.[323] HAMP modifications reduce the discrepancy between rental and mortgage payments, which means that strategic defaults are unlikely for HAMP modifications.

Necessitated defaults in negative equity situations, however, will be unavoidable. There are essential life factors that necessitate moves—the "Four Ds," Death, Disability, Divorce, and Dismissal—as well as childbirth, and improved employment opportunities. While negative equity alone is unlikely to produce redefaults for HAMP modifications, these additional factors combined with negative equity raise the likelihood of redefault.

A homeowner who loses a job with General Motors in Detroit may need to relocate for work. If the homeowner has $40,000 in negative equity and the homeowner cannot come up with that upon sale of the property, then default is the only option for the homeowner. Previous housing downturns have lasted over a decade, so given that the average homeowner moves approximately once every seven years[324] a great many homeowners with MHA modifications or refinancings will likely need to move at a time when they still have negative equity. This casts grave doubt on the sustainability of negative equity homeownership. To be sure, foreclosures produced by the combination of negative equity with life factors will not come in a rush, but they will produce a steady stream of foreclosures as long as there is negative equity.

b. Factors Affecting Loan Performance

It is difficult to predict the future performance of HAMP-modified loans. There is no performance history for loans with the HAMP-modified structure. OCC/OTS Mortgage Metrics indicate that redefault rates are significantly lower for modifications that reduce monthly payments, "with greater percentage decreases in payments resulting in lower subsequent redefault rates."[325] (See Figure 30, below.) Nonetheless, redefault rates even on modifications reducing payments by 20 percent or more were still a very high 34 percent.

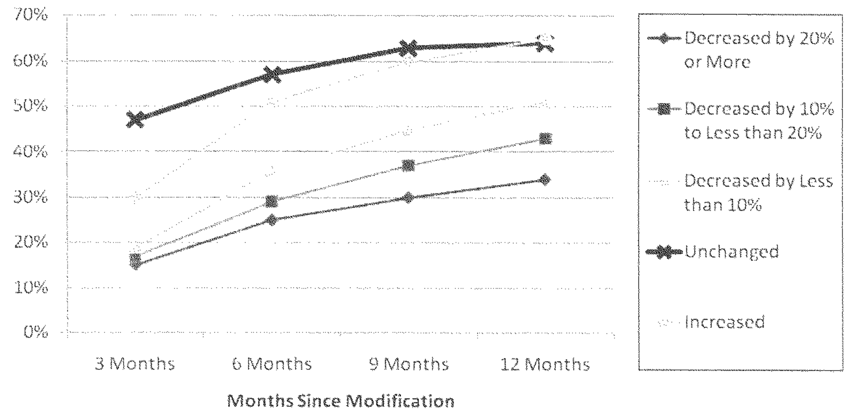
OCC/OTS data do not break down into subcategories the performance of modifications with monthly payment decreases of more than 20 percent. Permanent HAMP modifications as of September 1, 2009 have decreased monthly payments by a median (mean) of 40 (39) percent, so this might indicate that redefault rates will be lower than those in the OCC/OTS data category for payment reductions of 20 percent or more.

[323] Kenneth R. Harney, *Homeowners Who 'Strategically Default' on Loans a Growing Problem,* Los Angeles Times (Sept. 20, 2009) (online at www.latimes.com/classified/realestate/news/la-fi-harney20–2009sep20,0,2560658.story.

[324] U.S. Census Bureau, *Geographical Mobility/Migration: Calculating Migration Expectancy* (online at www.census.gov/population/www/socdemo/migrate/cal-mig-exp.html) (accessed Oct. 7, 2009).

[325] OCC and OTS Second Quarter Mortgage Report, *supra* note 42, at 34.

Figure 30: Redefault Rates of Loans Modified in 2008 by Change in Payment (Redefault=60+ Days Delinquent)[326]



The closest product for comparison is, ironically, the subprime mortgage loans of recent years, particularly hybrid-ARMs. Hybrid ARMs featured below-market introductory rates that would last for 2–3 years, after which rates would adjust to an index rate plus a premium. The rate reset would often result in a 20 to 30 percent increase in payments.[327] These loans were typically underwritten based on the borrower's ability to afford the initial introductory rate, rather than the rate after reset. Hybrid ARMs were also typically underwritten at near or up to 100 percent LTV. Many were also underwritten as 30-year mortgages with 40-year amortizations, meaning that there would be a balloon payment due at the end.

HAMP-modified mortgages have an initial median interest rate of 2 percent, significantly below market. The rate is fixed for five years, and then steps up over time to the lower of the original contract rate or the Freddie Mac 30-year fixed rate at the time of modification, currently around 5 percent. This means monthly payments for mortgages currently being modified could increase by over 45 percent between year five and year eight. Based on current income levels, monthly payments would go from 31 percent DTI to 45 percent DTI, approximately where the loans were before modification; the current median pre-modification DTI of HAMP modified loans is 45 percent.[328] Under these conditions, assuming the borrower's income has not changed, the affordability of the loans will move back toward pre-HAMP levels eight years from now. As noted by Deborah Goldberg of the National Fair Housing Alliance at the Panel's foreclosure mitigation field hearing, "We don't have

[326] OCC and OTS Second Quarter Mortgage Report, *supra* note 42, at 8.

[327] Structured Credit Investor, *Deeper and Deeper: Expiring ARM Teaser Rates to Drive ABX Delinquencies* (Oct. 31, 2007).

[328] Presumably, income will increase, if only due to inflation. Therefore, if income only kept pace with inflation, which it has failed to do in recent years, then DTI would rise, unless inflation over those eight years totaled 31 percent or nearly 4 percent per year. If inflation only averaged 3 percent per year, then the DTI burden would increase to 36 percent, while if inflation were 2 percent per year, then DTI burdens would go up to 39 percent, and DTI would rise to 42 percent if inflation averaged 1 percent per year.

really permanent modifications, right, we have five year modifications . . ." [329]

While HAMP rate resets are more gentle and gradual than those on subprime mortgages, HAMP modifications are also being underwritten based on the affordability of the introductory rate, not the affordability of the stepped-up rate. The maximum interest rate for a HAMP modified loan after step-up is currently low in absolute terms, but affordability is relative, not absolute. Moreover, the median LTV for HAMP-modified mortgages is 124 percent, significantly higher than that of a newly originated subprime mortgage. And because of principal forbearance and extensions of amortization periods beyond original loan terms, many HAMP-modified loans have a balloon payment due at the end of the mortgage. These factors could explain why Treasury might use a 40 percent redefault rate like other similar government programs in the first five years for HAMP modifications and higher rates with deeper levels of negative equity. If accurate, this sort of redefault rate calls into question the long-term effectiveness of HAMP.

c. Principal Reductions

Negative equity can only be eliminated through principal write-downs, but this raises a number of difficult and complex issues. When principal is written down, it impairs the balance sheets of the owners of the mortgages. In many cases, this means the impairment of the balance sheets of the very financial institutions whose stability is an essential goal of the EESA. To be sure, if principal write-downs actually increase the true value of the loans, by reducing redefault rates, then principal write-downs might cause more immediate losses, but they would produce more realistic, and therefore more confidence-inspiring, balance sheets.

One concern related to the idea of principal reduction is the incentives it may create. Witnesses at the Panel's foreclosure mitigation field hearing were asked about this matter. Dr. Paul Willen, Senior Economist at the Federal Reserve Bank of Boston, testified that the "problem with negative equity is basically that borrowers can't respond to life events." Borrowers with positive equity simply have "lots of different ways they can refinance, they can sell, they can get out of the transaction." [330] He noted that although most borrowers with negative equity are likely to make their payments in the present or over the next couple of years, they still remain "at-risk homeowners" and may face more serious issues several years down the road should a life changing event, such as unemployment, occur.[331] In that sense, Dr. Willen offered that principal reduction may have some virtue. He also noted, however, that most borrowers with negative equity make their mortgage payments, and that if principal reduction is provided as an option, one runs the risk of incentivizing borrowers, who would otherwise continue to make their mortgage payments, "to look for relief" even when it is not necessarily needed.[332] In this sense, according to Dr. Willen, mandating a principal reduction option under HAMP could put ad-

[329] Goldberg Philadelphia Hearing Written Testimony, *supra* note 99, at 85.
[330] Willen Philadelphia Hearing Testimony, *supra* note 305, at 110, 135.
[331] *Id.* at 135.
[332] *Id.* at 135.

ditional pressures on the program, and ultimately reduce its overall effectiveness. However, in response to a question from the Panel, Dr. Willen agreed that revising bankruptcy laws to permit principal modification was a clear way to address the idea that there should be a cost for receiving a principal reduction.

Other witnesses at the hearing also argued that the incentive "to look for relief" may be reduced if the costs to the borrower of opting for principal reduction were significantly greater.[333] For example, revising Chapter 13 bankruptcy to include a cramdown or a principal reduction component could be one way to impose more significant costs. Because of these costs, such a revision could provide borrowers with the option of principal reduction without creating the potential perverse incentives to other borrowers that may occur by mandating principal reduction as an option under HAMP. Filing for bankruptcy is not an appealing choice to any borrower; however, to the borrower facing certain foreclosure it may be the only choice. Whereas mandating principal reduction as an option under HAMP may attract a larger than desired group of borrowers, allowing principal reduction as an option under Chapter 13 is more likely to attract only those borrowers who are truly in need of such assistance. In this sense, Chapter 13 bankruptcy could be used as a tool to employ the benefits of principal reduction to borrowers in need without attracting other borrowers and putting any additional pressures on HAMP.

Likewise, concerns have been raised about whether Treasury has the authority to mandate principal reductions if it thought that to be a necessary action. While EESA does not give Treasury the power to abrogate contracts by fiat, Treasury has the power to place conditions on access to future TARP funds. Treasury has already done so by requiring institutions to participate in MHA, which mandates interest rate reductions and principal forbearance in certain circumstances. Treasury could therefore make principal reduction a condition for financial institutions and their affiliates to receive TARP assistance. Legally, there would be no distinction between Treasury conditioning TARP assistance on principal reductions and conditioning it on principal forbearance and interest rate reductions. While there are major accounting differences—principal reductions result in an impairment of assets, while interest rate reductions result in a reduction of future income, and principal forbearance has varied accounting treatment (potentially charged off and treated as a recovery when ultimately paid)—legally they are indistinguishable, as they all involve an alteration of a right to payment. Thus, if Treasury determined that principal reductions were essential for the success of foreclosure mitigation efforts, it would have a significant ability to achieve such reductions.

There are numerous ways in which negative equity could be addressed. The Panel merely notes these options and does not express an opinion at this time on their preferability:

- Principal reduction could occur already through HAMP modifications and HOPE for Homeowners refinancing.
- HAMP incentive structure could be revised to encourage principal reductions.

[333] Trauss Philadelphia Hearing Testimony, *supra* note 297, at 67, 91, 106.

- TARP funds could be spent to purchase principal reductions.
- Congressional action could encourage principal reductions through a variety of methods:
  - Mandatory national foreclosure mediation program.
  - Tax and CRA credits to incentivize principal write-downs.
  - Chapter 13 bankruptcy revisions.
  - New Deal-style repudiation of contracts as serving public policy.[334]

d. Unemployment

Rising unemployment also presents a foreclosure driver to which MHA was not designed to respond. Absent a source of income, neither refinancing nor modifications are possible. Historically, homes have been the single biggest source of wealth accumulation for families.[335] Millions of families count on financing their retirements by paying off their homes and using Social Security for daily expenses. In addition, home equity has provided emergency funds to families hit by medical problems, job losses, and divorce. An unemployed household could extract equity from a home to bridge that gap between jobs. Today, however, this is not possible because of negative equity; the home piggybank is empty. An extended period of negative home equity has grave implications for the middle class, because it means that an important part of their economic safety net is gone. This calls into question the long-term economic stability of a sizeable portion of the middle class. We are facing the threat of a vicious cycle: unemployment-driven foreclosures could exert downward pressure on real estate prices, depressed real estate prices dampen consumer consumption demand because of the high share of household wealth invested in real estate, and dampened consumer demand feeds continued high unemployment.

Even in cases in which there is not negative equity, however, unemployment lurks as a driver of foreclosures. Unemployment-driven foreclosures exert downward pressure on real estate prices and low real estate prices dampen consumer demand, which feeds continued high unemployment. The MHA programs, however, were not designed to deal with unemployment. Instead, they were designed to address the foreclosure crisis as it was understood in early 2009. Given the data lags on foreclosures, that meant the program was designed using data from the third quarter of 2008. A great deal has changed since then, however. In the third quarter of 2008, foreclosures were primarily a subprime problem; they had not yet become primarily a prime problem, and defaults on payment-option and interest-only mortgages were far off on the horizon. Moreover,

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[334] During the Great Depression, the government abandoned the gold standard and enacted large-scale debt relief for borrowers by declaring that the courts would no longer enforce gold indexation clauses in private contracts. Instead, borrowers were able to pay debts with the recently devalued dollar. The net effect was to reduce the debt burden of borrowers by nearly 70 percent. In enacting this policy, the government believed the economic "benefits of eliminating debt overhang and avoiding bankruptcy for private firms more than offset the loss to creditors." Randall Kroszner, *Is It Better to Forgive Than to Receive? Repudiation of the Gold Indexation Clause in Long-term Debt*, University of Chicago working paper (Oct. 1998) (online at faculty.chicagobooth.edu/finance/papers/repudiation11.pdf).

[335] Tracy M. Turner & Heather M. Luea, Homeownership, Wealth Accumulation and Income Status, Journal of Housing Economics, at 1 (forthcoming 2009) (online at www.k-state.edu/economics/turner/JHE2009ABTRACT.pdf).

unemployment was substantially lower.[336] The result is that MHA programs may not be adequate for the present and coming phases of the foreclosure crisis. While the program could be criticized for failure of prescience, the real question is whether federal foreclosure prevention programs will always be playing catch-up. To date this has been the case, as the federal government has consistently pursued the least interventionist approach possible to foreclosures at any given juncture.

Crafting programs to assist unemployed homeowners retain their homes is a crucial next step in foreclosure mitigation. During the Panel's foreclosure mitigation field hearing, Dr. Willen noted that "an effective plan must address the problem of unemployed borrowers" because "thirty-one percent of an unemployed person's income is often thirty-one percent of nothing and a payment of zero will never be attractive to a lender."[337] Dr. Willen also explained that his research "shows that, contrary to popular belief, unemployment and other life events like illness and divorce, much more than problematic mortgages, have been at the heart of this crisis all along even before the collapse of the labor market in the fall of 2008."[338] Although there was no surge in such life events in the months or years leading up to the crisis, he explained, falling real estate prices meant that foreclosure—and not a profitable sale, as would be the result if prices were rising—would be the result if a person became unemployed.[339] Other witnesses at the Panel's foreclosure mitigation field hearing, including Joe Ohayon of Wells Fargo Home Mortgage, agreed that the Making Home Affordable program should directly address unemployment-related foreclosures.[340]

There is precedent for such programs to assist the unemployed. One such effort, the Homeowners' Emergency Mortgage Assistance Program in Pennsylvania, was discussed above in Section 8B. The idea has also been authorized at the federal level. In 1975, Congress passed the Emergency Homeowners' Relief Act.[341] The Act provided standby authority for HUD to implement a program that would provide emergency loans and grants to help unemployed homeowners avoid foreclosure, and the Department of Housing and Urban Development—Independent Agencies Appropriations Act, 1976 (P.L. 94–116) appropriated $35 million to the Emergency Homeowners' Relief Fund in order to carry out this program. HUD's final rule on the standby program stipulated that the HUD Secretary could implement the Emergency Homeowners' Relief Program if a composite index of mortgage delinquencies reached 1.20 percent, a threshold several times lower than present delinquency rates. Because the threshold was never reached, the program was never implemented. Nonetheless, it provides a model of assistance to unemployed homeowners to carry them through an economic

[336] Bureau of Labor Statistics, *Data Retrieval: Labor Force Statistics* (accessed Oct. 6, 2009) (online at www.bls.gov/webapps/legacy/cpsatab1.htm).

[337] Congressional Oversight Panel, Testimony of Dr. Paul Willen, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 135 (Sept. 24, 2009).

[338] *Id.* at 110.

[339] *Id.* at 110.

[340] Congressional Oversight Panel, Testimony of Joe Ohayon, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 109 (Sept. 24, 2009) (hereinafter "Ohayon Philadelphia Hearing Testimony").

[341] Pub. L. 94–50, *codified at* 12 U.S.C. 2701 *et seq.*

downturn without imposing the deadweight losses of foreclosures on the economy.

The ultimate policy success of federal foreclosure prevention efforts hinges on whether they can produce sustainable results on a sufficient scale. In both matters of sustainability and scale, there are serious concerns about whether the existing programs are up to the task. Because circumstances have changed markedly since the roll-out of the MHA in February, the Panel suggests that Treasury consider new programs or make significant changes to existing programs to address the issue of job loss and the temporary inability to make mortgage loan payments.

4. Cost-benefit Analysis

In evaluating government programs, it is helpful to consider the costs and benefits, therefore the Panel asked Professor Alan White of Valparaiso University to conduct a cost benefit analysis, included as Annex B. Treasury estimates it will spend $42.5 billion for non-GSE Home Affordable Modification programs (HAMP), of which $23 billion has been contracted for, and that will buy about 2 to 2.6 million modifications, i.e. an average per-modification cost between $16,000 and $21,000. This includes the second lien modification component and the home price decline protection payments. Professor White's estimate of the probability-adjusted, discounted cost per modification is somewhat lower, but found an estimate in the range of $16,000 to $21,000 reasonable. Some of these payments go to servicers, while some are used to pay loan principal and interest, for the benefit of both homeowners and investors.

Professor White's analysis noted that the benefits of HAMP modifications include avoided investor losses and avoided external costs, which include homeowner relocation costs, neighboring property value effects and local government expenditures, probably equal to double or triple the investor benefits. He found that investor loss avoidance could potentially exceed $50,000 per modification, and homeowner, neighboring property and municipal foreclosure loss avoidance could amount to double that or more. On the other hand, Professor White indicated that the $16,000 to $21,000 payments are being made for some modifications that would have occurred anyway, and thus the benefits need to be discounted accordingly. He concluded that it is too early in the program to measure the magnitude of this displacement effect.

Other authors have considered that it is possible, of course, that modifications are failing to keep pace with foreclosures because modifications fail to maximize the present value of mortgages, making foreclosure a rational economic decision, even if it is not in the public interest. This theory has been propounded most notably in a working paper published by the Federal Reserve Bank of Boston.[342] As the paper explains, the net present value of modifying a defaulted loan depends on the rate of redefaults, the extent to which losses on redefaults exceed losses in foreclosure without a modification, and the rate at which mortgagors cure their defaults without modification. Likewise, the net present value of a non-modified but defaulted loan depends on the self-cure rate and the

[342] Redefaults, Self-Cures, and Securitization Paper, *supra* note 142.

loss severities in foreclosure. The paper correctly argues that if self-cure rates and redefault rates are sufficiently high, modifications will not maximize net present value.

The paper, which uses a 10 percent random sample of data from Lender Processing Services (formerly McDash) data from 2007–2008, which covers approximately 60 percent of the market, also cites what appear to be quite high self-cure and redefault rates of 25–30 percent and 30–50 percent respectively, depending on loan, borrower, and modification characteristics.[343] These rates are not an accurate description of present realities, however. According to Fitch Ratings, the self-cure rate at present is between 4.3 percent and 6.6 percent, depending on type of loan.[344]

Moreover, redefault rates are highly contingent on the type of modification, so basing NPV calculations on redefault rates has a circular logic. As OCC/OTS Mortgage Metrics reports and the Boston Fed study shows, modifications that reduce monthly payment have a much lower redefault rate.[345] It also stands to reason that the manner in which monthly payments are reduced (i.e. via interest rate reduction, term extension, principal forbearance, principal forgiveness) might also impact redefault rates. A borrower with positive equity and an affordable mortgage will be much more incentivized to avoid a redefault than a borrower with negative equity, who has already lost his investment in the home. Additionally, the Boston Fed study might underestimate losses on foreclosure and overestimate the additional losses caused by redefault, especially if housing markets have bottomed out.

In any event, the Boston Fed study never actually tests the rates it cites in the net present value calculation it presents. The Panel's staff tested the Boston Fed staff's NPV formula with very conservative assumptions, and found that even when using the Boston Fed staff's much-higher-than-current self-cure and redefault rates, there is still room to undertake a NPV maximizing modification (see Annex A). When more realistic assumptions about self-cure, redefault, and foreclosure losses are used, there is significant room to undertake NPV maximizing modifications for a wide range of loan inputs.

Accordingly, it does not appear that foreclosure is usually the decision that rationally maximizes value for mortgagees. Foreclosure may be a rational, value-maximizing decision for servicers, but it is often not for lenders. While there is a range of cases in which foreclosure will maximize NPV for mortgagees, these appear to be the exception, not the rule.

5. Servicer Compliance with HAMP Guidelines

While Treasury has broad policy issues to consider for the evolution of the foreclosure mitigation initiative, it still must administer the current programs in the most effective manner possible. A key element to HAMP's success is the degree to which servicers comply with the program's guidelines. If borrowers face incorrectly rejected applications, unreasonably long wait times for responses to

343 *Id.* at table 8.
344 Fitch Release, *supra* note 22.
345 OCC and OTS Second Quarter Mortgage Report, *supra* note 42; Redefaults, Self-Cures, and Securitization Paper, *supra* note 142.

questions and completed applications, lost paperwork, and incorrect information, HAMP will not reach its full potential. At the Panel's foreclosure mitigation field hearing, Seth Wheeler, senior advisor at the Treasury Department, testified, "We are working to establish specific operational metrics to measure the performance of each servicer. These performance metrics are likely to include such measures as average borrower wait time in response to inquiries and response time for completed applications. We plan to include these metrics in our monthly public report."[346]

This is critical, as borrowers and advocates continue to report numerous problems. Eileen Fitzgerald, chief operating officer of NeighborWorks America (which provides funding to housing counselors across the country) testified at the Panel's foreclosure mitigation field hearing that a great deal of time is wasted during the loan modification process because each participating servicer uses different forms and imposes different requirements. "There is a huge process problem here," she said. Housing counselors have reported other problems, as well, including: (1) exceedingly long telephone wait times before speaking to a servicer (2) inexperienced personnel unfamiliar with program details; (3) misplaced documentation often leading to delays in processing; (4) a significant lag period between application and final approval for trial modifications; and (5) the failure of servicers to reach out to distressed homeowners.[347] Preliminary information also suggests some participating servicers violate HAMP guidelines in a number of much more serious ways, including requiring borrowers to waive legal rights, offering non-compliant loan modifications, refusing to offer HAMP modifications, charging borrowers a fee for the modification, and selling homes at foreclosure while the HAMP review is pending.[348] Others have found such violations as "[d]enials of HAMP modifications for reasons not permitted in the guidelines, such as—'insufficient income' and 'too much back-end debt,'" assertions by participating servicers that they are not bound by HAMP, and incorrect "claims of investors denying HAMP modifications."[349]

The Panel heard similar stories at its foreclosure mitigation field hearing. Advocates on behalf of homeowners testified that some servicers have erroneously been telling homeowners that only Fannie Mae and Freddie Mac loans are eligible for HAMP modification. Some servicers have been wrongly claiming that only underwater loans are eligible. Some servicers have been misinforming

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[346] Wheeler Philadelphia Hearing Testimony, *supra* note 88, at 6.

[347] See Congressional Oversight Panel, Testimony of NeighborWorks America Chief Operating Officer Eileen Fitzgerald, *Philadelphia Field Hearing on Mortgage Foreclosures* (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/ hearing–092409–philadelphia.cfm); Goldberg Philadelphia Hearing Testimony, supra note 99; Tami Luhby, 5 Dumb Reasons You Can't Get Mortgage Help, CNNMoney (Aug. 11, 2009) (online at money.cnn.com/2009/08/11/news/ economy/ dumb___.reasons___no___mortgage___modification/).

[348] House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, Written Testimony of Alys Cohen, National Consumer Law Center, *Progress of the Making Home Affordable Program: What Are the Outcomes for Homeowners and What are the Obstacles to Success*, at 3 (Sept. 9, 2009) (online at www.house.gov/apps/list/hearing/ financialsvcs___dem/cohen___-___nclc.pdf); National Consumer Law Center, *Desperate Homeowners: Loan Mod Scammers Step in When Loan Servicers Refuse to Provide Relief*, at 8 (July 2009) (online at www.consumerlaw.org/issues/mortgage___servicing/content/ LoanModScamsReport0709.pdf) ("Stories abound of exasperated homeowners attempting to navigate vast voice mail systems, being bounced around from one department to another, and receiving contradictory information from different servicer representatives.").

[349] NYC Anti-Predatory Lending Task Force, Letter to Assistant Secretary Herb Allison (July 23, 2009) (online at www.nedap.org/documents/HAMPtaskforceletter.pdf).

homeowners by saying that the investors who own their loans have not given the servicers permission to participate in the program. And these witnesses also testified that some servicers have wrongly been asking housing counselors to provide their own Social Security numbers.[350] Until specific compliance data become available, news from the field provides the only picture of whether modifications are conforming.[351]

HAMP has a built-in compliance structure. Treasury has designated Freddie Mac as the compliance agent, and tasked the agency with performing announced and unannounced onsite and remote audits and reviews of participating servicers.[352] As part of its compliance duties, Freddie Mac is developing a "second look" process to audit modification applications that have been declined by servicers.[353] However, GAO has stated its concern that Freddie Mac does not yet have "procedures in place to address identified instances of noncompliance among servicers."[354] Advocates have also noted that very little is known about the schedule, nature, or outcome of Freddie Mac's compliance reviews.[355]

Some servicers, to their credit, concede that they must improve their systems. After Treasury and HUD met with servicers in late July to inform them that they must increase the number of modifications, several servicers issued statements in response. Bank of America's statement announced, "Despite our aggressive efforts to find solutions for homeowners in default, we must improve our processes for reaching those in need."[356] At a recent hearing, a representative of Wells Fargo stated that "some customers have been challenged with getting clear, timely communication from us, as the guidelines and the requirements for the various programs have continued to change."[357] Servicers must iron out the wrinkles in their implementation of HAMP, and Treasury must quickly put its compliance plan into place, in order for all eligible borrowers to fully benefit from HAMP.

As with all TARP programs, transparency is crucial. Borrowers should understand why a modification is being denied. On October 1, Treasury announced that it has met its goal of establishing "denial codes that will require servicers to report the reason for modi-

[350] Fitzgerald Philadelphia Hearing Testimony, *supra* note 147, at 71. Goldberg Philadelphia Hearing Testimony, *supra* note 99.

[351] Chris Arnold, *Major Banks Still Grappling With Foreclosures*, NPR (Sept. 9, 2009) (online at www.npr.org/templates/story/story.php?storyId=112660935) (While the reporter shadowed a call center worker, the worker incorrectly denied an application for HAMP modification.).

[352] GAO HAMP Report *supra* note 98, at 38, 42.

[353] Congressional Oversight Panel, *Questions for the Record from the Congressional Oversight Panel at the Congressional Oversight Panel Hearing on June 24, 2009*, at 6. GAO HAMP Report, *supra* note 98, at 42.

[354] *GAO HAMP Report supra* note 98, at 43. GAO was particularly concerned that "while Treasury has emphasized in program announcements that one of HAMP's primary goals is to reach borrowers who are still current on mortgage payments but at risk of default, no comprehensive processes have yet been established to assure that all borrowers at risk of default in participating servicers' portfolios are reached." *Id.*

[355] Goldberg Philadelphia Hearing Testimony, *supra* note 99.

[356] Andrea Fuller, *U.S. Effort Aids Only 9% of Eligible Homeowners*, New York Times (Aug. 4, 2009) (online at www.nytimes.com/2009/08/05/business/05treasury.html).

[357] House of Representatives Committee on Financial Services, Subcommittee on Housing and Community Opportunity, Testimony of Mary Coffin, Wells Fargo, *Progress of the Making Home Affordable Program: What Are the Outcomes for Homeowners and What are the Obstacles to Success*, 111th Cong. (Sept. 9, 2009) (Video available online at www.house.gov/apps/list/hearing/financialsvcs____dem/coffin____-____wf.pdf).

fication denials, both to Treasury and to borrowers."[358] This is an important step, but the denial codes must also contain borrower recourse should the reason be invalid.

While the Panel is pleased with Freddie Mac's commitment to "using a number of fraud detection and compliance techniques in their sampling and compliance reviews" and a focus on "borrower, servicer, and systemic fraud, as well as quality control,"[359] this alone is insufficient. Monitoring alone is ineffective unless accompanied by meaningful penalties for failure to comply. This is particularly important to address patterns of willful lack of compliance with program standards by participants. At the Panel's foreclosure mitigation field hearing, Irwin Trauss, supervising attorney of the consumer housing unit at Philadelphia Legal Services, said there should be immediate negative consequences for servicers that fail to meet their obligations in the program. "If you sign the participation agreement, then you're supposed to follow the rules," he said. "But there's no teeth."[360] Treasury has provided servicers, investors, and borrowers with a set of carrots to encourage participation in the program. It also needs a full range of compliance tools, or sticks, to make sure participants adhere to program guidelines and procedures.[361]

E. Conclusion and Recommendations

Treasury has created programs designed to address some of the items on the Panel's March checklist for a successful foreclosure mitigation program, with a focus on affordability. Yet, despite the passage of six months, many of these programs remain in their early stages and do not yet have a demonstrated track record of success, especially on the points of second liens, servicer incentives, borrower outreach, and servicer participation. The Panel intends to monitor carefully all available data on these and other points going forward to make further recommendations regarding the effectiveness of MHA.

1. Areas Not Adequately Addressed by MHA

While MHA is making progress in meeting some of its objectives, the current programs do not encompass the entire scope of the foreclosure crisis, which has significantly expanded in scope since MHA was announced seven months ago. To maximize the effectiveness of the federal foreclosure mitigation effort, Treasury should be forward looking and attempt to address new and emerging problems before they reach crisis proportions.

First, the current MHA framework appears to be inadequate to address the coming wave of payment-option ARM and interest-only loan rate re-sets that is looming in the near future, a concern very specifically raised by the National Fair Housing Alliance and by Litton Loan Servicing at the Panel's foreclosure mitigation field

[358] Wheeler Philadelphia Hearing Testimony, *supra* note 88; Andrews Frustrated Homeowners, *supra* note 148.

[359] Congressional Oversight Panel, Written Testimony of Freddie Mac Senior Vice President, Economics and Policy, Edward Golding, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 4 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony–092409–golding.pdf).

[360] Trauss Philadelphia Hearing Testimony, *supra* note 333, at 91.

[361] Goldberg Philadelphia Hearing Testimony, *supra* note 99.

hearing.[362] This challenge should be addressed now, before many families find that the federal initiative offers them no relief from foreclosure.

Second, unemployment has continued to increase since the inception of MHA, and job loss is a strong driver of foreclosure. In particular, Treasury needs to find ways to provide foreclosure mitigation for unemployed or underemployed individuals, a point underscored by Dr. Paul Willen at the Panel's foreclosure mitigation field hearing, and reiterated by Joe Ohayon of Wells Fargo Home Mortgage Service.[363] One possible way to address the needs of those who are unemployed would be to replicate Pennsylvania's successful Homeowner Emergency Mortgage Assistance Program (a type of bridge loan program for unemployed mortgagors) on a national scale.[364] At the Panel's foreclosure mitigation field hearing, virtually all of the witnesses acknowledged the promise of this program.

Third, the existing federal foreclosure mitigation effort has also failed to deal with negative equity in a substantial or programmatic way, possibly calling into question the long-term sustainability of some modifications and refinancings. Principal reduction is the primary way to eliminate negative equity, and the Panel recognizes that there are serious legal and bank safety and soundness considerations that accompany each of the various options Treasury and Congress could employ to achieve principal reduction.

2. MHA Program Improvements

As it administers MHA and any subsequent program evolutions, Treasury must be mindful of several key points to maximize success.

Transparency. First, the programs must be transparent. Information on eligibility and denials should be clear, easily understood and promptly communicated to borrowers. The denial process should include appropriate appeals for those denied incorrectly. Denial information should then be aggregated and reported to the public. Treasury should also release the NPV models, a point stressed by NeighborWorks and the National Fair Housing Alliance,[365] so that they can be used by borrowers and borrowers' counselors. While Treasury has made marked progress in its data collection, more data on HAMP borrowers should be made public in a timely, useful way, similar to HMDA data. Data collection should also be expanded to include information on a broader universe of borrowers facing foreclosure, beyond those eligible for HAMP. The Panel looks forward to Treasury's fulfillment of its recent commitment to provide greater and deeper disclosure of servicer quality, responsiveness, capacity, and other performance

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[362] Goldberg Philadelphia Hearing Testimony, *supra* note 99; Litton Philadelphia Hearing Written Testimony, *supra* note 124, at 4.

[363] Willen Philadelphia Hearing Written Testimony, *supra* note 305, at 109–110, 137–138; Ohayon Philadelphia Hearing Testimony, *supra* note 340, at 137–139.

[364] Trauss Philadelphia Hearing Written Testimony, *supra* note 297, at 3. At the foreclosure mitigation field hearing in Philadelphia, the Panel received a proposal from the lawyers working at the Pennsylvania program for a national scale project. See Hearing Record, Congressional Oversight Panel, *Philadelphia Field Hearing on Mortgage Foreclosures* (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm).

[365] Goldberg Philadelphia Hearing Testimony, *supra* note 99, at 8–9; Fitzgerald Philadelphia Hearing Testimony, *supra* note 147.

data. These transparency commitments should apply equally to HARP, for which there has been a decided lack of data, and HAMP.

Streamlining process. Next, Treasury should implement greater uniformity into the loan modification system. Certainly, MHA was a significant step forward in creating an industry standard for loan modification, but borrowers and advocates continue to cite frustration with the differing forms and procedures from lender to lender.[366] Lenders have expressed frustration as well, including Bank of America before the Panel.[367] Creating further uniformity in the process will make it easier to educate borrowers on how the process works, as well as promote greater effectiveness for housing counselors. Treasury should continue current efforts to streamline and unify the process through its planned web portal and other means. Streamlining and standardizing the income documentation that verifies a borrower's income will increase the likelihood that modifications are executed in a timely fashion. Additional efforts to improve case management and customer communication are also needed.

Program enhancement. Several witnesses at the Panel's foreclosure mitigation field hearing made constructive recommendations for program enhancement that Treasury should consider. First, many of the NPV model standards rely on statewide averages and there are instances in which these averages can be inappropriate (home sales, foreclosure timeframes, etc.). More granular local information should be incorporated. Second, several witnesses, including borrowers and servicers, expressed the need for the DTI eligibility test to go below 31 percent in order to accommodate borrowers for whom the modified capitalized arrearages would move them from below 31 percent (ineligible) to above 31 percent DTI (eligible), capturing additional borrowers at risk. Third, there were useful suggestions for ombudsmen and designated case staff to help borrowers cut through the red tape and have consistency in who they speak to at the servicer.

Accountability. It is also critical for the success and credibility of the foreclosure mitigation programs to have strong accountability. Freddie Mac has been selected to oversee program compliance, and this is an important step. Freddie Mac and Treasury must outline a rigorous framework, including procedures to address non-compliance. It is critical that the program have strong, appropriate sanctions to ensure that all participants follow program guidelines. The performance metrics currently being developed by Treasury can play an important role in providing accountability. To maximize their effectiveness, the metrics should be comprehensive, and the results should be made public, with results available by lender/servicer.

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[366] Goldberg Philadelphia Hearing Testimony, *supra* note 99, at 8–9; Fitzgerald Philadelphia Hearing Testimony, *supra* note 147.

[367] Congressional Oversight Panel, Testimony of Bank of America Home Loans Senior Vice President for Default Management, Allen Jones, *Philadelphia Field Hearing on Mortgage Foreclosures*, at 144–49 (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm) (hereinafter "Jones Philadelphia Hearing Testimony").

ANNEX A: EXAMINATION OF SELF-CURE AND RE-DEFAULT RATES ON NET PRESENT VALUE CALCULATIONS

The net present value (NPV) calculation for a servicer is a comparison of the NPV of an unmodified delinquent loan to the NPV of a modification of that same delinquent loan. A NPV is the probability-weighted average of the various present values of different outcomes. If the NPV of the modified loan is greater than the NPV of the unmodified loan, then a modification is value maximizing for the investors in the loan. We can thus present a simple comparison of the NPV of the same defaulted loan if modified and unmodified.

If a delinquent loan is not modified, there is a chance (P_C) that the borrower will cure without assistance. There is also a possibility that there will be a foreclosure (P_F). The NPV of the unmodified delinquent loan is thus the weighted average of the value of the self-cured loan and the value of the loan in foreclosure.

If the delinquent loan is modified, there is a chance that the loan will perform as modified, but only as modified (P_M). There is also a chance that the modification was unnecessary, as the defaulted would have been cured without the modification (P_{C-M}). There is also a chance that the loan will redefault (P_R), which could cause greater losses to the mortgagee in a falling market. Thus the NPV of the modified loan is the weighted average of the values of the unnecessarily modified loan, the redefaulted modified loan, and the performing modified loan.

Thus the NPV of a modified loan is only greater than the NPV of the unmodified loan if: $P_M + P_{C-M} + P_R + \geq P_C + P_F$

This model can be tested against various market assumptions. A working paper published by the staff of the Boston Federal Reserve found that in 2007–2008 the self-cure rate (P_C and P_{C-M}) on a sample of loans from the LPS database, covering approximately 60 percent of the mortgage market, was 30 percent.[368] This means that the chance of foreclosure if the loan is unmodified (P_F) is 70 percent. The study also found redefault rates (P_R) on modified loans in the range of 40 percent. Therefore the rate of successful, necessary modifications (P_M) is 30 percent. Also assume that loss severities in foreclosure are 50 percent and that loss severities on redefault are 75 percent. These are, respectively, optimistic and pessimistic assumptions. Finally, assume that the mortgage in question, if it *performed* unmodified, would have a NPV of $200,000.

Using a stated NPV for an unmodified loan permits us to avoid having to model the NPV of a loan and discount rate and prepayment assumptions, etc. These factors are vitally important in the NPV analysis that a servicer undertakes, and depend on numerous factors like loan structure. To examine the claim put forth in the Boston Federal Reserve study, however—namely that foreclosure is in most cases a rational, value maximizing response—we need nearly assume an NPV for an unmodified loan. Given the nature of the formula, however, the assumed NPV is ultimately immaterial to the outcome.

[368] Redefaults, Self-Cures, and Securitization Paper, *supra* note 142.

Given these assumptions, we can then solve for M, which is the minimum NPV of the loan as modified that would still maximize NPV relative to the defaulted loan unmodified:

$P_M = .3M$

$P_{C\text{-}M} = .3M$

$P_R = .4 * (1-.75) * \$200,000 = \$20,000$

$P_C = .3 * \$200,000 = \$60,000$

$P_F = .7 * (1-.5) * \$200,000 = \$70,000$

Thus $P_M + P_{C\text{-}M} + P_R + \geq P_C + P_F$ is: $.3M + .3M + \$20,000 > \$60,000 + \$70,000$

We can simplify this as: $.6M + \$20,000 \geq \$130,000$ and solve for M:

$.6M \geq \$110,000$

$M \geq \$183,333.33$

This means that even using the Boston Federal Reserves's findings on self-cure and redefault rate plus very conservative assumptions on redefault losses, the principal and/or interest on the mortgage could be written down such that the NPV of the loan would go to $183,333.33 and the modification would still maximize net present value for the mortgagee. In other words, a modification would still be value maximizing, even with an 8.33 percent reduction in NPV from the NPV of the loan performing unmodified.

Notice that this outcome does not depend on the assumed NPV of the unmodified loan if it performed. If we substituted a variable X for the unmodified NPV of the loan if it performed, we would find that $M \geq 55/60 * X$. As there is always a positive difference between X and $55/60 * X$, there is some room for a modification using these assumptions, regardless of the size of the mortgage.

If we use more current assumptions, such as a 6 percent self-cure rate (P_C and $P_{C\text{-}M}$) and a 35 percent redefault rate (P_R), then the unmodified loan will end up in foreclosure (P_F) 94 percent of the time, and will perform as modified, but only as modified (P_M), 59 percent of the time. Let us also assume, more plausibly, loss severities in foreclosure at 60 percent and on redefault at 65 percent. With these assumptions, we see a much greater modification is possible.

$P_M = .59M$

$P_{C\text{-}M} = .06M$

$P_R = .35 * (1-.65) * \$200,000 = \$24,500$

$P_C = .06 * \$200,000 = \$12,000$

$P_F = .94 * (1-.5) * \$200,000 = \$94,000$

Thus $P_M + P_{C\text{-}M} + P_R + \geq P_C + P_F$ is:

$.59M + .06M + \$24,500 > \$12,000 + \$94,000$

We can simplify this as $.65M + \$24,500 \geq \$106,000$ and solve for M:

$.65M \geq \$81,500$

$M \geq \$125,384.61$

Using more realistic assumptions, the principal and/or interest on the mortgage could be written down such that the NPV of the loan would go to $125,384.61 and the modification would still maximize net present value for the mortgagee. In other words, a modification would still be value maximizing, even with a 37 percent reduction in NPV from the NPV of the loan performing unmodified. Again, once the assumptions about redefault and self-cure rates are fixed, the outcome does not depend on the size of the mortgage. While the Boston Federal Reserve study is correct that self-cure and redefault rates play a major role in servicers' NPV calculations, even with the extremely high self-cure and redefault rates found in the LPS data from 2007–2008, there was still room for value-maximizing modifications for quite standard loans. With current default and self-cure rates and further depressed foreclosure sale markets, there is even greater room for modifications possible.

ANNEX B: POTENTIAL COSTS AND BENEFITS OF THE HOME AFFORDABLE MORTGAGE MODIFICATION PROGRAM

A. Alan M. White

1. Introduction

The following discussion of the costs and benefits of homeowner assistance programs funded by TARP is necessarily qualitative, rather than quantitative, and preliminary in light of the very recent implementation of most of the initiatives under study. The focus will be on the first lien modification program, rather than the smaller deed-in-lieu and short sale program, whose per-home and total costs are much smaller. The GSE refinance program, which does not receive TARP funds directly, is not discussed.

The continuing absence of mortgage performance data collection and reporting by Treasury hampers the effort to measure the costs and benefits of the programs and to evaluate any progress being made in bringing the foreclosure crisis to an end. The ultimate yardstick for evaluating any foreclosure-relief program is reduction in the number of foreclosure filings and foreclosure sales. Related indicators, such as early delinquencies, as well as details about modification application approvals and rejections, self-cure rates, and redefault rates on modified loans, need to be reported on a timely and regular (preferably monthly) basis.[369]

2. Description of Taxpayer-Funded Mortgage Borrower, Servicer, and Investor Assistance Programs Being Funded Through TARP

Treasury has allocated $50 billion to make incentive payments and loan subsidies to servicers of non-GSE mortgages under the Home Affordable Mortgage Program (HAMP). An additional $25 billion will be spent by the GSEs for a similar modification incentive program, but those funds are not TARP funds.[370] The incentive payments include extra compensation to servicers for the work required to modify mortgage loans and payments to reduce loan balances and interest rates. The former payments benefit servicers, and the latter payments benefit both investors and homeowners. Investors benefit by the reduced risk of non-payment of their remaining balances and homeowners benefit from reduction of their debt. Treasury has allocated $10 billion to Home Price Decline Protection payments made to reduce mortgage debt in areas where home prices are subject to unusually high decline, such as in the sand states of Florida, Nevada, Arizona, and California. These latter payments afford an incentive to investors to agree to modifications and benefit both investors and homeowners by repaying and reducing mortgage debt.

[369] This point was made in the Congressional Oversight Panel's March 2009 report as well as in a July Government Accountability Office report. Congressional Oversight Panel, *March Oversight Report: Foreclosure Crisis: Working Toward a Solution* (Mar. 6, 2009) (online at cop.senate.gov/documents/cop-030609-report.pdf); GAO HAMP Report, *supra* note 98.

[370] Fannie Mae and Freddie Mac have received large capital infusions under TARP, and so any expenditure by the GSEs, to the extent it reduces profits or erodes share values, indirectly reduces repayment of TARP funds. Like Treasury, the GSEs should be reporting data on mortgage modifications, servicer payments and foreclosures.

Treasury has also announced two related HAMP initiatives: to address second mortgages and to encourage foreclosure alternatives for homeowners who are giving up their home (short sale/deed in lieu program). The cost of these programs is included in the $40 billion for HAMP. Servicers may receive incentive compensation of up to $1,000 for successful completion of short sale or deed-in-lieu, and borrowers may receive incentive compensation of up to $1,500 for relocation expenses. Treasury will also contribute up to $1,000, on a $1 to $2 basis, to assist investors in buying out second lien holders to make a sale or deed-in-lieu workable and allow recovery by the first mortgage investors.

3. The General Case for Promoting Mortgage Modifications

One in eight mortgages, representing nearly seven million homes, is now delinquent or in foreclosure.[371] Mortgage servicers are starting new Foreclosures at a rate of 250,000 per month, or three million per year.[372] foreclosures are at roughly quadruple their pre-crisis levels.[373] Each additional foreclosure is now resulting in direct investor losses of more than $120,000.[374] In addition, each foreclosure results in direct costs to displaced owners and tenants and indirect costs to cities and towns, neighboring homeowners whose property values are driven down, and the broader housing-related economy. When we speak of investors to whom mortgage payments are due, we are speaking in part about taxpayers, who now own a major share of America's mortgages. Taxpayers are mortgage investors directly through Treasury and Federal Reserve investments in mortgage-backed securities (MBS), and indirectly through FHA and VA insurance and through equity investments and guarantees in Fannie Mae, Freddie Mac, and other financial institutions that carry mortgages and MBS on their books. If HAMP is successful in reducing investor losses, those savings should translate to improved recovery on other taxpayer investments.

Experience in prior debt crises and in the current crisis has shown that well-designed mortgage restructuring programs, in which borrowers in default or likely to default are offered payment reductions or extensions rather than having their property foreclosed, can significantly mitigate losses that investors and taxpayers would otherwise suffer. The mortgage servicing industry ramped up its levels of voluntary mortgage modifications in 2007 and 2008, with mixed results. On one hand, nearly two million mortgages were modified, avoiding foreclosure at least temporarily and restoring some cash flow for investors. On the other hand, modifications were limited compared to the much larger number of

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[371] MBA National Delinquency Survey, *supra* note 4 (Reporting 8.86% of mortgages delinquent and 4.3% in foreclosure as of June 30, 2009, out of 44,721,256 mortgages, representing 85% of all first mortgages).

[372] HOPE NOW, *Workout Plans and Foreclosure Sales, supra* note 2 (reporting 254,000, 251,000, and 284,000 foreclosure starts for May, June, and July 2009, respectively.).

[373] Mortgage Bankers Association, *National Delinquency Survey* (Apr. 2006).

[374] The average loss recorded for foreclosure sale liquidations in securitized subprime and alt-A mortgages in November 2008 was $124,000. Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Contract Modifications*, 41 Connecticut Law Review 1107, at 1119 (2009) (hereinafter "Deleveraging the American Homeowner"). Losses per foreclosure have continued to rise since then. Current monthly data on foreclosure losses are available at: www.valpo.edu/law/faculty/awhite/data/index.php.

mortgages in default and foreclosure, and redefault rates on voluntary modifications have been as high as 50 percent or more. Nevertheless, there is convincing evidence that successful modifications avoided substantial losses, while requiring only very modest curtailment of investor income. In fact, the typical voluntary modification in the 2007–2008 period involved no cancellation of principal debt or of past-due interest, but instead consisted of combining a capitalization of past-due interest with a temporary (three to five year) reduction in the current interest rate. Foreclosures, on the other hand, are resulting in losses of 50 percent or more, i.e. upwards of $124,000 on the mean $212,000 mortgage in default.[375]

While modification can often result in a better investor return than foreclosure, modification requires "high-touch" individualized account work by servicers for which they are not normally paid under existing securitization contracts (pooling and servicing agreements or PSAs).[376] Servicer payment levels were established by contracts that last the life of the mortgage pools. Servicers of subprime mortgages agreed to compensation of 50 basis points, or 0.5 percent from interest payments, plus late fees and other servicing fees collected from borrowers, based on conditions that existed prior to the crisis when defaulted mortgages constituted a small percentage of a typical portfolio. At present, many subprime and alt-A pools have delinquencies and defaults in excess of 50 percent of the pool. The incentive payments under HAMP can be thought of as a way to correct this past contracting failure.

Ideally, investors might have foreseen the need for servicers to perform expensive loss mitigation work in order to maximize the return on the mortgages and provided in PSAs for servicers to be compensated for the extra work when the extra work would be economically justified. However, PSAs do not make such provisions. They have been aptly described as Frankenstein contracts.[377] Because mortgage servicers are essentially contractors working for investors who now include the GSEs, the Federal Reserve, and Treasury, we can think of the incentive payments under HAMP as extra-contractual compensation for additional work that was not anticipated by the parties to the PSAs at the time of the contract. The additional compensation is justified to the extent that the investors will receive more than $1 in present value of additional mortgage cash flow for every $1 paid to the servicer for the required loss mitigation effort.

To illustrate the benefits of modification, we can use an example based on actual mortgage modifications reported by servicers in August 2009. The average August modification reduced the homeowner's payment by $182 per month on a loan with an average balance of $222,000. A foreclosure on mortgages in this amount resulted in average investor losses of roughly $145,000.[378] Assuming a 10 percent self-cure rate,[379] an unmodified mortgage, currently in

[375] Deleveraging the American Homeowner, *supra* note 374.

[376] Standard & Poor's, *Servicer Evaluation Spotlight Report* (July 2009) (online at www2.standardandpoors.com/spf/pdf/media/SE__.Spotlight__.July09.pdf).

[377] Gelpern & Levitin Frankenstein Contracts, *supra* note 143.

[378] Data tabulated by Prof. Alan M. White from Wells Fargo Corporate Trust Services mortgage-backed securities investor reports (online at www.valpo.edu/law/faculty/awhite/data/index.php).

[379] The self-cure rate refers to the percentage of delinquent mortgages being considered for modification that can be expected to return to current status and eventually be paid in full with-

default, will result in a probability-weighted present value loss of roughly $130,000. In other words, if the servicer does NOT modify the loan, the likely result on average is a $130,000 loss to the investor.

In comparison, a modification that simply reduces interest from seven percent to 5.1 percent, resulting in a $225 payment reduction for five years (more than the typical August 2009 modification), would reduce the investor's cash flow by a present value of $13,000. Even when we assume that 40 percent of modified loans will redefault,[380] the weighted, present value loss from modifying such a loan would be around $48,000 (blending the small losses from successful modifications with the large losses from the failed modifications that revert to foreclosure).

The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60 percent or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more. Two million modifications with a 60 percent success rate could produce $160 billion in avoided losses, an amount that would go directly to the value of the toxic mortgage-backed securities that have frozen credit markets and destabilized banks.[381]

4. Analysis of the Costs and Benefits of Homeowner Assistance Funded through TARP

Any discussion of costs and benefits of the HAMP must begin with a caveat. The benefits of any intervention to reduce foreclosures necessarily involve predictions about repayment of mortgages, whether they are unmodified, modified, or refinanced. Predictions about probabilities of mortgage repayments and defaults are inevitably subject to a large margin of error, particularly in the current, unprecedented market environment. On the other hand, some elements are known with reasonable certainty, such as the likely losses that result from an individual foreclosure sale.

To construct a very rough estimate of the costs and benefits of the HAMP we proceed in two steps. First we estimate the benefits and costs of intervention for each individual modified mortgage. The per-modification estimate is adjusted by the probability of successful repayment after modification (HAMP payments are not made if the homeowner defaults in payments on the modified loan). Second, we need to determine to what extent HAMP has resulted

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out modification. Prior to the crisis as many as 30 percent of delinquent borrowers were able to catch up on payments on their own, but in recent months the self-cure rate has declined dramatically and is currently between 4 percent and 7 percent. Fitch Ratings, BusinessWire, *Fitch: Delinquency Cure Rates Worsening for U.S. Prime RMBS* (Aug. 24, 2009) (online at www.businesswire.com/news/home/20090824005549/en).

[380] Redefault rates are an important factor in measuring the costs and benefits of HAMP. OCC/OTS report that modifications made in 2008 have redefaulted at a rate of about 40 percent after six months. Modifications that reduced monthly payments by 10 percent or more had significantly lower default rates, in the range of 25 percent to 30 percent. HAMP modifications, by requiring reduction of the monthly payment, should result in lower redefault rates than prior voluntary modifications, which often increased payments and/or total debt.

[381] These calculations are based on the publicly available FDIC loan modification present value model. An example calculation is set forth in the spreadsheet in appendix 1. The results depend, of course, on assumptions about loss severities, self-cure rates, and redefault rates, among other things. This example is based on current FDIC assumptions. If servicers can identify homeowners with enough income to have at least a 60 percent chance of successful repayment, modification can save investors significant amounts compared to allowing most unmodified delinquent loans to go to foreclosure.

or will result in additional successful modifications, compared with the number of modifications that would have occurred anyway without these policy interventions. In other words, the second component of the analysis requires an estimate of the replacement effect or the extent to which HAMP will compensate servicers to do what in some instances they might have done anyway.

5. Costs and Benefits of an Individual HAMP Subsidized Mortgage Modification

Subsidy Costs. Treasury has allocated $50 billion for servicer and investor payments for non-GSE loans, including the $10 billion set aside for Home Price Decline Protection. As of August, roughly $23 billion of this total had been committed through contracts with individual servicers.[382] Treasury contemplates increasing these caps as servicers successfully complete modifications and draw down funds.

Thus, we know the potential cost of the program because it has been capped by contract and by authorization. What we do not know in order to make a meaningful cost-benefit comparison is the number of successful modifications that the $23 billion in contracts, or $50 billion authorized, will purchase. Answering that question requires estimating the cost of an individual modification.

Treasury has estimated that between two and 2.6 million borrowers will receive loan modifications assisted by HAMP payments funded by TARP, i.e., mortgages not held by the GSEs.[383] The total projected expenditure for these HAMP modifications consists of the $50 billion total minus the amounts spent for the non-modification foreclosure alternatives (deed-in-lieu and short sale program). Allocations of the $50 billion are not fixed, and Treasury will adjust them depending on utilization of the programs. Simple division yields a per-modification cost of roughly $20,000, if 2.5 million borrowers are helped with the maximum $50 billion in program funds.

The subsidy costs can also be approximated by adding up the components of HAMP assistance and estimating an average per-modification subsidy. This estimation is complex because HAMP payments are made over time and are not made for unsuccessful modifications, so that redefault probability adjustment and present value discounting are required.

HAMP payments are made over a five-year period. Treasury has agreed to pay $1,000 or $1,500 initially, plus $1,000 per year for up to three years to the servicer for each successful modification, and also $1,000 per year for up to five years towards principal debt reduction for each successful modification (for a potential total of $9,000 or $9,500 of incentives per modification). In addition, Treasury will pay a Monthly Payment Reduction Subsidy (MPRS) to bring the borrower's debt-to-income ratio down from 38 percent to 31 percent when necessary. The payment is equal to one-half the amount required to reduce the borrower monthly payment to 31 percent DTI from 38 percent DTI.

[382] A current list of HAMP contracts and with servicers and their cap amounts appears in U.S. Department of the Treasury, *Troubled Asset Relief Program, Monthly Progress Report for August 2009*, at 59 (Sep. 10, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/105areport_082009.pdf).

[383] GAO HAMP Report, *supra* note 98, at 14.

The Home Price Decline Protection payments are in addition to the $9,000 in incentives and the payment reduction subsidy, and are more difficult to estimate. As the GAO report notes, it is not clear why Treasury believes it will be necessary to provide these additional subsidies for modifications that are NPV positive, i.e., that the servicer should make without the subsidy, when the other payments fully compensate the servicer for the transaction costs of modifications.

Second lien modification program: Separate funds are allocated to support the modification of second mortgages for borrowers who receive a first mortgage modification. Although Treasury has estimated that between one-third and one-half of first mortgages modified under HAMP will need assistance for a second mortgage, it is unlikely that all second mortgages will be successfully modified.

Based on Treasury's estimates, the total amount required for a single HAMP modification—combining the basic HAMP payments with the cost estimates for payment reduction subsidy, HPDP and second lien payments—average subsidies for a single modification would be about $20,350.[384] In order to compare costs and benefits meaningfully, all program costs should be reduced to present value. The $9,000 in basic incentive payments over five years for an average individual modification translates to roughly $7,800 in present value cost for a successful modification, using the current Freddie Mac rate as the discount rate, reducing the total to $18,150.

Some modified loans will fail, and in those cases some of the HAMP payments will not be made. It is therefore necessary to adjust the program cost by a probability of redefault factor. If we assume an average 30 percent redefault rate, and that the mean time to redefault is six months, with virtually all redefaults occurring within 12 months, the present value, probability-adjusted cost of the program per modified loan would be about $15,850.[385] A lower redefault rate would mean higher program costs. The present value and probability adjustments must be made both for cost and for benefit estimates in order for these estimates to be comparable. Treasury's estimate of $16,000 to $21,000 per HAMP modification is presumably based on more conservative assumptions, or more optimistic projections about redefault rates.

To summarize, the total cost of the borrower, servicer, and investor incentive payments for first and second mortgage HAMP payments is projected to be in the range of $16,000 to $21,000 average per first mortgage modification, including both successful and unsuccessful modifications. In other words, the cost per successful modification will be higher. Treasury should be in a position to report on actual per-modification costs by November or December, when several months of permanent modification data have been collected and some initial redefault statistics can be calculated.

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[384] This includes the $9,000 in basic servicer and borrower incentive payments, plus Treasury's discounted estimates for the monthly payment reduction cost share, the Home Price Decline Protection payments, and the average cost of second lien modification spread across all first lien modifications. It does not include the non-retention foreclosure alternatives program. Estimates of these costs were obtained from Treasury.

[385] Assuming 70 percent of the modifications result in full payment of the $9,000 basic subsidies, and 30 percent result in payment of only the $1,000 initial payment and 6 months of interest subsidies with no second lien or Home Price Decline Protection payment.

Note on Moral Hazard Costs. Moral hazard in this context refers to the cost of losses on mortgages that would otherwise perform but for the borrower's decision to default in order to benefit from the program. Initially, it should be noted that mortgage servicers are already modifying tens of thousands of mortgages every month voluntarily, so the moral hazard cost of HAMP would require a determination of the additional impetus, if any, that HAMP might cause for voluntary defaults over and above the effect of present servicer loss mitigation. This could occur, for example, if homeowners regarded the chance of obtaining $5,000 in potential principal reduction payments as a sufficient incentive to default on their mortgage.

It is theoretically possible that some homeowners, who would not become delinquent in the absence of either the voluntary modification program or the enhanced program stimulated by HAMP incentive payments, will choose to become delinquent to benefit from the program. In this context, moral hazard is nearly impossible to measure. Defaults and delinquencies on mortgages that do occur are thought to result from a combination of factors including mortgage product features, borrower life events like unemployment, and negative equity making it impossible to sell or refinance the home. If a borrower were certain that any delinquency would automatically result in a modification that saves the borrower money, he or she might have an incentive to default.

There are three reasons moral hazard from HAMP modifications is unlikely to play a significant role in borrower defaults. First, the likelihood of obtaining a modification involving permanent concessions is understood by most borrowers to be low. Many modifications simply reschedule payments, without reducing total debt. In fact, most modifications to date have increased principal debt, because unpaid arrears are added to the loan balance.[386] HAMP modifications reduce payments, but servicers may still capitalize unpaid interest and fees and thereby increase total debt. The average amount capitalized in 2008 was $10,800.[387] The HAMP principal reduction payments would thus not be sufficient to motivate a strategic default, especially in light of the countervailing cost a strategic defaulter would pay in impaired credit scores.

Second, the probability of obtaining any modification is uncertain—there is a huge variation among servicers in the number of modification requests that are being granted or denied. Servicers are overwhelmed with applications, and many homeowners and mortgage counselors report significant difficulty in obtaining modifications. Thus a strategic defaulter would take the risk that a modification would not be approved or processed before foreclosure and loss of the property.

Third, program eligibility rules are designed to prevent borrowers who do not have genuine financial difficulties from obtaining any loan concessions. In other words, borrowers are screened to minimize moral hazard. Applicants for modifications must document their income, in order to prove that they cannot afford their

[386] Deleveraging the American Homeowner, *supra* note 374, at 1113, 1114. The OCC/OTS Mortgage Metrics Report for the Second Quarter of 2009 reports that of 142,362 modifications in the second quarter, 91,590 included capitalization of arrears.

[387] Deleveraging the American Homeowner, *supra* note 374, at 1114.

full contract payment without modification. Borrowers who can already afford their mortgage will not receive a modification. The documentation requirements have been demanded by investors precisely to prevent moral hazard issues from arising. They can create difficulties for homeowners with a genuine need, but the extra transaction cost is justified on the basis that it will minimize moral hazard for undeserving borrowers.

Further study and analysis beyond the scope of this discussion would be necessary to determine whether existing measures are sufficient to keep moral hazard costs at a minimum. Thus far, there has been no reported empirical evidence of significant moral hazard costs resulting from either the voluntary mortgage modifications of 2007 and 2008 or the HAMP modification program. In other words, the existence of any mortgage defaults motivated solely or primarily by the availability of either voluntary modifications or HAMP modifications has not been demonstrated.

Benefits. The direct and most easily measured benefit of HAMP modification assistance is the reduction in foreclosure losses borne by investors, including notably Treasury, Federal Reserve and GSEs. The direct investor savings from a successful modification program are measured by comparing the present value of a delinquent loan without modification to its value after modification, the so-called net present value or NPV test. Every modification must be subjected to the NPV test. It will be vitally important for Treasury to monitor the NPV test results for HAMP modifications, in order to see whether the program costs are justified. If average investor savings, discounted and probability-adjusted, are in excess of $50,000, as in the hypothetical model discussed above, the benefits would clearly outweigh the costs. On the other hand, if many modifications are resulting in only a marginally positive NPV, the wisdom of the subsidies may need to be revisited, unless they can be justified based on other cost savings.

Apart from the investor savings, homeowners who successfully repay a modified mortgage will realize significant benefits in avoiding the moving costs, impaired credit, and other measurable impacts of a foreclosure and eviction from their homes. In addition, for every additional foreclosure prevented by a successful modification, external costs of foreclosures are avoided. These include the decline in home values of neighboring properties and the lost tax revenue, increased crime and other costs borne by local communities.

The benefits to homeowners and communities from preventing a foreclosure are more difficult to quantify, but should not be ignored in any plausible cost benefit analysis. The easiest positive externality to measure is the impact of foreclosure sales on surrounding home values. Immergluck and Smith determined that each single foreclosure in Cook County, Illinois drove down neighboring home values by a total of $158,000.[388] Another external cost that has

[388] Daniel Immergluck and Gregory Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosure on Property Values,* Housing Policy Debate, Vol. 17, No. 1, at 57 (Jan. 2006) (online at www.mi.vt.edu/data/files/hpd%2017%281%29/hpd__1701__immergluck.pdf); Vicky Been, Ingrid Gould Ellen, and Jenny Schuetz, *Neighborhood Effects of Concentrated Mortgage Foreclosures,* 17 Journal of Housing Economics, at 306 (Dec. 2008) (online at furmancenter.org/files/foreclosures08-03.pdf).

been quantified somewhat is the cost to cities, especially of concentrated foreclosures. A municipality may spend as much as $30,000 per vacant property as a result of a foreclosure.[389] The amounts lost by families who lose their homes, in moving costs, replacement housing, and indirect effects, has not been reliably estimated, but are clearly a significant cost that is avoided when a modification is successful. Precision is impossible in estimating these benefits from foreclosure prevention. Nevertheless these benefits are real, and should not be discounted. As a very rough approximation, the external benefits of foreclosure prevention are at least double the amounts of direct investor savings from a successful modification. To put it another way, measuring only investor savings will capture less than a third of the likely economic benefits.

6. Substitution Effect and Prior Voluntary Modifications

The second step in a cost benefit analysis would be to measure the extent to which HAMP has increased modifications over the number that were already occurring voluntarily. Data for July and August suggest that HAMP has resulted in a net increase of about 85,000 modifications per month. In August, Treasury reports that there were about 120,000 temporary HAMP modifications. Those were offset by a decline of around 35,000 in non-HAMP permanent modifications compared with prior months.[390] Because very few HAMP three-month temporary modifications have become permanent, it is too early to tell how many additional modifications HAMP has produced. In very rough terms, it appears that at least in August, about 29 percent of HAMP modifications were replacing permanent modifications that would have been put in place voluntarily without subsidy payments. Thus, the net benefit of the program (benefits minus costs) should realistically be discounted to some extent to account for the substitution effect.

On the other hand, even HAMP modifications that might be regarded as having substituted for prior, voluntary modifications will be, on average, more likely to succeed and more beneficial for homeowners. This is because of HAMP's requirement to reduce borrower debt ratios to 31 percent. This level of payment reduction has not been the norm prior to HAMP. Significant payment reduction is likely to improve the chances of borrower success and the resulting investor and public savings. HAMP will thus improve the quality and uniformity of mortgage modifications even to the extent it does not increase their total number.

Nevertheless, Treasury will need to monitor closely the conversion rate of temporary modifications to permanent modifications, and the overall maintenance of effort by servicers, to determine whether HAMP payments are stimulating a net increase in permanent modifications.

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[389] William Apgar, Mark Duda, and Rochelle Gorey, *The Municipal Costs of Foreclosure: A Chicago Case Study,* Homeownership Preservation Foundation (Feb. 27, 2005) (online at www.hpfonline.org/content/pdf/Apgar__Duda__Study__Full__Version.pdf).

[390] For August 2009 HOPE NOW reported 86,000 permanent modifications, which is a decline of 34,000 from the 120,000 monthly range seen in months prior to HAMP implementation. HOPE NOW, *HOPE NOW Data Shows Increase in Workouts for Homeowners* (Sept. 30, 2009) (online at www.hopenow.com/press__release/files/August%20Data%20Release__09__30__09.pdf).

7. Other Benefits

In addition to the incremental foreclosure prevention that HAMP will buy, the program may have other long-term benefits for the mortgage industry. By standardizing the calculation of net present value, improving the likelihood of success and the quality of loan modifications, and gathering better data on modified loan performance, the Treasury intervention may produce improvements in industry knowledge and practices. Mortgage servicers may realize efficiencies from greater uniformity in documenting modifications, applying uniform NPV criteria, and may thus increase investor community confidence in the modification and loss mitigation process. The HAMP template could continue to be used after subsidy ends, and continue to improve practices in the servicing industry.

If HAMP is successful in producing greater investor savings and reduced foreclosures, Treasury should consider how and when to phase out the incentive payments, or reduce them to the minimum level needed to maintain the necessary servicer incentives. The payments being made to servicers are substantial, and perhaps more than are absolutely necessary to compensate servicers for loss mitigation activity. Servicers could be encouraged to reveal the marginal cost of good modifications through a competitive bidding process, allowing servicers to bid for the lowest compensation level necessary to continue processing all feasible modifications.

Finally we should not overlook the macroeconomic benefits that a successful foreclosure reduction program may achieve. If the steadily growing inventory of foreclosed homes can be reduced, home prices can begin to stabilize, and the housing and mortgage industries can return to being a stimulus rather than a drag on the economy. The true measure of whether the $50 billion HAMP investment pays off will be whether foreclosure filings and the inventory of foreclosed homes begin returning to normal levels.

ANNEX C: EXAMINATION OF TREASURY'S NPV MODEL

The Panel has examined Treasury's NPV model and notes that it is highly sensitive to small changes in certain parameters as well as quite inflexible in other regards. The Panel conducted a sensitivity test on the HAMP NPV model by using a baseline model where the variables of the loan are NPV neutral such that the NPV of the modified loan is approximately equal to the NPV of an unmodified loan. Starting with this control, the Panel staff tested the sensitivity of six major variables:

1. Discount Rate—According to the HAMP Base NPV working paper, a servicer can override the default discount rate (PMMS) and add a risk premium up to 250 basis points for loans in their portfolio or loans they manage on behalf of investors. They may use only two risk premiums: one they apply to all loans in portfolio, and another they apply to all PLS loans. The discount rate impacts the present value of the projected future cashflows of the loans—a higher discount rate increases the extent to which the investor values near-term cash flows more than the same cash flows in the future. Using the baseline loan to conduct the test, the Panel's staff found that only a one basis point change in the risk premium is necessary to change the outcome of the test for the baseline loan from NPV positive to NPV negative. As such, this risk premium is a very sensitive variable that can change the NPV outcome from positive to negative.

2. Geographical Region—The metropolitan statistical area (MSA) in which a property is based affects the Housing Price Index and the Home Price Depreciation Payment. Other variables, such as foreclosure timeline, REO costs, and the REO sale discount due to stigma, vary at the state level. Accordingly, by changing the MSA of a property, the NPV value of the modification (the difference between the NPV of cash flows in the mod- and no-mod scenarios) varies by as much as $10,000 for the example loan.

3. Mark-to-Market Loan-to-Value ratio (MTMLTV)—The MTMLTV of a loan reflects the size of a borrower's debt relative to the value of their house. The more the borrower owes relative to the value of their house, the more likely they are to default on the loan, the less likely they are to refinance or sell the home (prepay), and the less of outstanding balance of the loan the lender recovers in foreclosure. For these reasons, the NPV model is sensitive to MTMLTV. Using the baseline loan, which has an MTMLTV of 0.72, an increase in MTMLTV ratio by one basis point holding all other variables constant turns the example loan from NPV negative to NPV positive. This is because an increase in MTMLTV increases the probability of default and redefault and changes their relative magnitudes, and lowers the recovery rate of the unpaid balance in foreclosure. In the case of the example loan—holding all else constant—the NPV increases as MTMLTV approaches 125 percent (the borrower owes 25 percent more than their house is worth) and declines thereafter. The point at which increasing the MTMLTV would change from raising to lowering the NPV depends on other inputs, such as the discount rate, the level of delinquency, foreclosure costs, FICO score, and the borrower's pre-mod debt-to-income ratio.

4. FICO Score—Another variable tested was the FICO score. The borrower's FICO score reflects their probability of default and also their ability to borrow, which affects their ability to refinance their home or to sell their existing home and buy another—in other words, to prepay. The test found that when the impact of the borrower's FICO score on the NPV value of the modification varies with other inputs, most notably their MTMLTV. For loans with relative low MTMLTV, there is an inverse relationship between FICO score and the NPV value. This is because for loans where the borrowers have significant equity in the home, raising the FICO score lowers the probability of default in the no-mod case more than it lowers the probability of default in the mod case. For loans with relatively high MTMLTVs, the NPV value of the modification increases with the borrower's FICO score. This is because the high FICO score lowers the probability of default in the mod case more than it lowers the probability of default in the no-mod case.

5. Borrower's Income—The Panel staff also analyzed the impact of the borrower's income on the NPV of the modified and non-modified loan. The borrower's income affects how much their monthly payments must be reduced to achieve a 31 percent DTI ratio (ratio of monthly mortgage payments—including taxes, insurance, and HOA fees—to monthly income). Increasing income also reduces the probability of default and redefault (by different amounts), since the borrower's starting DTI is an input in the default-probability calculator. Delinquency of the Loan—After a loan is 90+ days delinquent, default probabilities, and cash flows upon default become fixed in the HAMP NPV model—additional months of delinquency do not change these values. The only variable factors for 90+ day delinquent loans are the cash flows on the no-mod cure scenario and—to a lesser extent—the cash flow on the mod-cure scenario. As a loan becomes more delinquent, the past-due interest and escrow amounts are assumed to be paid up-front in the no-mod cure scenario and capitalized into the UPB in the cure scenario. This means that in the HAMP model, the NPV of the no-mod scenario increases relative to the NPV of the modification scenario once a loan is 90+ days delinquent. Accordingly, once a loan becomes 90+ days delinquent, the difference between the no-mod scenario and the modification scenario will increasingly favor not modifying the loan.

SECTION TWO: ADDITIONAL VIEWS

A. Richard H. Neiman

I voted for the Panel's October Report (the "Report") and I agree with its central themes and recommendations. As directed by the Congress in EESA, Treasury's foreclosure mitigation efforts are vitally important to protecting homeowners, strengthening the housing market, and aiding economic recovery. I believe that much more needs to be done to help people in need now and during the foreclosure surge that will continue over the next several years.

I am providing these Additional Views to clarify some points in the Report and amplify others.

1. It Is Too Early To Make Conclusive Judgments About HAMP, HARP and MHA

MHA had many obstacles, problems, and operational and technological challenges getting started and the HAMP program is just now gaining momentum. Because we are in a period where so many trial modifications are on the books and so few have had time to convert to permanent modifications, I believe it is too early to judge the program or to imply that HAMP will not be successful.[391]

I think that Treasury's current run rate goal of 25,000 trial modifications per week—or 1.3 million per year—is a robust goal. If achieved and sustained with a solid conversion rate of trial modifications to permanent modification, HAMP can provide a tremendous benefit for millions of American homeowners.

Early trial-to-permanent modification conversion rates have been low, as the Report points out, but there are a range of reasons (e.g., the temporary 60-day extension of the trial modification period; early documentation and capacity issues; etc.) why it is still several months too early to draw any meaningful conclusions. I suggest that Treasury issue its own projections for trial-to-permanent conversion rates as soon as possible in order to provide guidance on this issue.

We should give the program time to work and re-visit HAMP within six months when a better track record and better service quality and performance results are available.

2. In Fact HAMP Has Great Potential

HAMP was designed to make loans more affordable for homeowners by lowering monthly payments thereby giving the most immediate and meaningful relief to the greatest number of homeowners.

Thus far, HAMP modifications have resulted in a mean interest rate reduction of 4.65 percent from approximately 7.58 percent to approximately 2.93 percent with mean monthly savings of $740 per loan reducing payments from on average $1890 to $1150, a 39-percent payment decline.[392] These are very impressive affordability numbers on a still-too-small base of loans. As HAMP gains momen-

[391] See *supra* p. 98 and accompanying notes (HAMP is "unlikely to have a substantial impact" and "is better than doing nothing.").
[392] See *supra* pp. 50, 53 and accompanying notes.

tum the direct savings to homeowners and investors and the benefits to society should be enormous. In fact, the Report contains a cost benefits study of mortgage modifications that found preliminarily, that the potential direct and indirect benefits to borrowers, investors, and society substantially outweigh the costs of HAMP loan modifications.[393]

3. Borrowers' Grievances Are Real

The Panel's September 20th Philadelphia hearing, which featured lively testimony from servicers, borrower groups, Treasury, Fannie Mae and Freddie Mac, demonstrated that there is a lot of room for improvement in the programs. Borrowers have been frustrated with unresponsive servicers, lost documents, time delays, unclear reasons for denial, and a host of other problems.

The scale up period is over. Servicers have had time to make improvements and should by now be organized to handle the case load in a highly professional and expeditious manner. Consequently, there should be no further systemic excuses regarding capacity.

4. HAMP Does Not Address Every Defaulted Loan—Other Issues Need Other Policy Solutions

It is not a design shortcoming of HAMP that it does not address every default-related issue. I agree with the Report that HAMP was not primarily designed to address the issues of negative equity, unemployment and option ARMs.

I endorse the view that Treasury should review these issues carefully and explain whether it intends to pursue additional policy solutions or program enhancements that are specifically targeted to these problems. One recommendation to address unemployment is to consider the use of TARP funds to support existing state programs or to encourage states to develop new programs that provide temporary secured loan payment assistance to the recently unemployed.[394] In considering possible programs to address the effects of negative equity, policymakers must address issues of moral hazard, bank safety and soundness, contract, and fairness, including the fairness issue related to sharing future equity appreciation.

5. We Can Only Measure Success With a Comprehensive National Metric That Tracks Defaults and Foreclosures

The Report notes that even if HAMP modifies hundreds of thousands of loans a year it may not be enough to stem the rising tide of 2–3 million foreclosure starts a year. Yet, it is difficult to know how many foreclosures are preventable because we have poor national industry information. We need to know more about foreclosure starts: How many result in foreclosure sales? How many cure? How many go to short sale or other solution that results in a lost home? How many are modified and saved? How many cannot be prevented by any means?

There is a tremendous need for better residential mortgage default and foreclosure metrics and I would like to see the Treasury-

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[393] See *supra* Annex B, "Potential Costs and Benefits of the Home Affordable Mortgage Modification Program," by Professor Alan M. White.

[394] See discussion of Pennsylvania's successful HEMAP program *supra* pp. 90–91.

GSE-MHA-Servicer partnership take the lead in providing clear understandable and comprehensive metrics about the housing market, especially delinquent loans and foreclosures, on a national basis by state of residence.[395]

I previously encouraged Congress to enact a national mortgage loan performance reporting requirement applicable to all institutions who service mortgage loans, to provide a source of comprehensive intelligence about loan performance, loss mitigation efforts and foreclosure.[396] Federal banking or housing regulators should be mandated to analyze the data and share the results with the public. A similar reporting requirement exists for new mortgage loan originations under the Home Mortgage Disclosure Act. Because lenders already report delinquency and foreclosure data to credit reporting bureaus, it would be feasible to create a tailored performance data standard that could be put into operation swiftly.

The country and its policymakers desperately need this kind of information and given the projections for a protracted period of foreclosures, it is well worth the effort.

6. Pushing Ahead

Mortgage reforms are critical at the state and national levels, reforms that I believe are necessary to aiding the millions of homeowners for whom unachievable mortgage payments and potential foreclosure are painful realities. We cannot turn back now. We must push ahead with the borrower-lender-government partnership that has been launched and build it out and improve on it. We need more hands on the oars, we need better cooperation and we need much better information and default mitigation tools.

B. Congressman Jeb Hensarling

Although I appreciate the work the Panel and staff members have done in preparing the October report, I do not concur with the conclusions and recommendations presented and, accordingly, dissent from the adoption of the report. Foreclosure mitigation is mentioned in the Emergency Economic Stabilization Act, EESA (P.L. 110–343), so it is an important mission for the Panel to assess the effectiveness of loan modification programs as they relate to this objective as well as to taxpayer protection.

1. Executive Summary

While I acknowledge the extensive research that went into this report on foreclosure mitigation and wish to thank the Panel for incorporating some of my edits and ideas, I believe several areas are either overlooked completely or present challenges to conducting proper oversight. In the following, I hope to shine a light on key

[395] Currently, for example, the OCC/OTS Mortgage Metrics Report reports on the subset of bank-serviced loans. However the OCC/OTS report (a) covers only 64% of the U.S. mortgage market, (b) is published three months after quarter end, and (c) does not break out information by state or servicer. Other databases have the same shortcoming of incompleteness making comparability nearly impossible and resulting in confusing and conflicting statistics.

[396] House Joint Economic Committee, Testimony of Richard H. Neiman on behalf of the Congressional Oversight Panel, *TARP Accountability and Oversight: Achieving Transparency* (Mar. 11, 2009) (online at jec.senate.gov/index.cfm?FuseAction=Files.View&FileStore_id=38237b7d-74fe-4960-9fc6-68f219a03c0f).

issues relating to the Panel's analysis of housing policy and the Administration's foreclosure mitigation programs.

A fair reading of the Panel's majority report and my dissent leads to one conclusion—HAMP and the Administration's other foreclosure mitigation efforts to date have been a failure. The Administration's opaque foreclosure mitigation effort has assisted only a small number of homeowners while drawing billions of involuntary taxpayer dollars into a black hole.

While the Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs, instead of focusing its attention on taxpayer protection and oversight, the Panel's majority report implies that the Administration should commit additional taxpayer funds in hopes of helping distressed homeowners—both deserving and undeserving—with a taxpayer subsidized rescue.

While there may be some positive signals in our economy, recovery remains in a precarious position. Unemployment will hit 10 percent in 2010, if not this year. This is unfortunate because the best foreclosure mitigation program is a job, and the best assurance of job security is economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. Without a robust macroeconomic recovery the housing market will continue to languish and any policy that forestalls such recovery will by necessity lead to more foreclosures.

Regardless of whether one believes foreclosure mitigation can truly work, taxpayers who are struggling to pay their own mortgage should not be forced to bail out their neighbors through such an inefficient and transparency-deficient program. Both the Administration and the Panel's majority appear to prioritize good intentions and wishful thinking over taxpayer protection.

To date, despite the commitment of some $27 billion,[397] only about 1,800 underwater homeowners have received a permanent modification of their mortgage. If the Administration's goal of subsidizing up to 9 million home mortgage refinancings and modifications is met, the cost to the taxpayers will almost surely exceed the $75 billion already allocated to the MHA—Making Home Affordable—program,[398] and it is likely that most (if not all) of it will not be recovered.

Taxpayers deserve a better return on their investment than what they are set to receive from AIG, Chrysler, GM and the Administration's flawed foreclosure mitigation efforts.

Professor Alan M. White, an expert retained by the Panel, notes in a paper attached to the Panel's report: "The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60-percent or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more."

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[397] U.S. Department of the Treasury, *TARP Transactions Report* (Oct. 2, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_10062009.pdf). This figure is defined by the current "Total Cap" for the Home Affordable Modification Program: $27,247,320,000.

[398] The Making Home Affordable program presently consists of the HAMP—Home Affordable Modification Program—and the HARP—Home Affordable Refinancing Program—programs.

Taxpayers—through TARP or otherwise—should not be required to subsidize mortgage holders or servicers when foreclosure mitigation efforts appear in many cases to be in their own economic best interests. The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP—Home Affordable Modification Program—and HARP—Home Affordable Refinancing Program—programs (with a reasonable expectation that additional funds may be forthcoming), has arguably caused them to abandon their market oriented response to the atypical rate of mortgage defaults in favor of seeking assistance from the government.

Any foreclosure mitigation effort must appear fair and reasonable to the American taxpayers. It is important to remember that the number of individuals in mortgage distress reaches beyond individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs. Distinct from a moral hazard question there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble.

In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is: "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair.

Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple mitigation programs that do not amplify taxpayer risk or require government mandates. Subsidized loan refinancing and modification programs may provide relief for a select group of homeowners, but they work against the majority who shoulder the tax burden and make mortgage payments on time.

The following are topics that I will cover in my response.

- The Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs.
- Determination of costs is especially important if, as Treasury Secretary Geithner has stated, TARP is interpreted to be a "revolving facility." Given the likelihood that he will extend TARP to October 31, 2010, it's possible that a substantial portion of the $700 billion TARP facility could be directed to foreclosure mitigation efforts.
- EESA charges the Panel with a clear duty to provide information on foreclosure mitigation programs, but with the caveat that it must be with an eye towards *taxpayer protection*. The October report places policy recommendations above this statutory duty.
- In order to better appreciate the total all-in costs of the Administration's various foreclosure mitigation efforts and to ensure taxpayer protection, and to compensate for the Panel's gaps in oversight, the Administration should promptly provide the taxpayers with a thorough and fully transparent analysis of the following matters:

(i) the total amount of funds the Administration has advanced and committed to advance under its various foreclosure mitigation efforts (including, without limitation, under MHA, HAMP and HARP, the second lien programs, as well as the programs adopted by Fannie Mae and Freddie Mac);

(ii) the total amount of funds the Administration reasonably expects to advance and commit to advance over the next five years under all of its present and anticipated foreclosure mitigation efforts; and

(iii) the total anticipated costs to all financial institutions and other mortgage holders and servicers under all of the Administration's present and anticipated foreclosure mitigation efforts.

- Treasury should be held accountable for key performance metrics as well. With 360,000 trial modifications underway, only 1,800 permanent modifications in place, and at least $27 out of $50 billion committed to the MHA—Making Home Affordable—program for loan modifications, by all appearances, Treasury is still a long way from its goal of assisting 3 to 4 million homeowners.
- All of the false starts with HAMP and the other government programs may have exacerbated the foreclosure mitigation process by keeping private sector servicers and mortgage holders on the sidelines waiting on a better deal from the government. By creating a perceived safety net, the foreclosure mitigation efforts advocated by the Administration may encourage economically inefficient speculation in the residential real estate market with its adverse bubble generating consequences.
- Housing GSEs—Government Sponsored Enterprises—Fannie Mae and Freddie Mac play key roles in the Administration's new housing policies. Funds from the Preferred Share Purchase Agreements, which allow the GSEs to draw up to $400 billion from Treasury, are being deployed for foreclosure mitigation and refinancing efforts. Since Fannie Mae and Freddie Mac are now under the conservatorship of the Federal Housing Finance Agency (FHFA), their concerns are now officially the taxpayer's concerns—any losses they experience through MHA should be a carefully considered part of a cost-benefit analysis.
- Fannie Mae and Freddie Mac should be more forthcoming with respect to their foreclosure mitigation efforts and use of taxpayer funds by addressing the questions that I pose later in the report.
- Due to flaws in the incentive structure for large-scale, loan modification programs, the Panel seems to support substituting federal bankruptcy judges for the traditional role performed by servicers and mortgage holders in loan modifications. Such a change in law will add to the increasing burden borne by the vast majority of homeowners who meet their mortgage obligations each month by encouraging non-recourse speculative investment in the residential housing market.
- Since one of Treasury's fundamental mandates is taxpayer protection, the incorporation of a shared appreciation right or equity kicker feature would appear appropriate. Homeowners should not receive a windfall at the expense of the taxpayers and mortgage lenders who suffered the economic loss from restructuring their distressed mortgage loans.

• Evaluation of a taxpayer-subsidized loan modification must consider the tremendous government interventions already underway. Private capital investment is scarce in today's housing market, replaced by recent, rapid growth in the government's share of the mortgage markets.

• Subsidized loan refinancing and modification programs may provide relief for a select group of homeowners, while working against the majority who shoulder the tax burden and make mortgage payments on time. Moral hazard is not just an issue of fairness—programs that give no consideration to the rightful, necessary link between risk and responsibility could potentially create additional housing "bubbles" and result in greater threats to stability.

• Overall, the Panel continues to place policy objectives above transparent and critical oversight. I recommend an oversight plan with several requirements be considered by the Panel.

2. Cost of the Foreclosure Mitigation Plans to Taxpayers

In order to have an informed debate on the foreclosure mitigation issue it's critical that the American taxpayers understand the all-in costs of all foreclosure mitigation efforts. This is particularly significant since approximately 95 percent of taxpayers meet their monthly rental and mortgage obligations and these taxpayers will be asked to subsidize the cost of any foreclosure mitigation efforts directed for the benefit of those who do not meet their obligations.

3. CBO—100 Percent Subsidy Rate for HAMP; Calculation of Total All-In Cost

A key distinction between the TARP-funded Capital Purchase Program and Treasury's foreclosure mitigation efforts is that the latter will most likely carry a subsidy rate to the taxpayers of 100 percent—that is, a 100 percent rate of loss for the taxpayers from the Home Affordable Modification Program (HAMP).[399] The Congressional Budget Office (CBO) has applied a 100 percent subsidy rate to the $50 billion of TARP funds committed to HAMP. It has not performed subsidy rate analysis for non-TARP financing of HAMP. According to CBO:

> The Treasury has committed $50 billion in TARP funding for the Administration's foreclosure mitigation plan, under which the TARP will make direct payments to mortgage loan servicers to help homeowners refinance their loans. Because no repayments will be required from the servicers, the net cost of the program will be the full amount of the payments made by the government.

Under these conditions, a 100 percent subsidy rate will be applicable throughout the entire HAMP lifecycle. A 100 percent subsidy rate becomes particularly problematic if—as announced with respect to the MHA program—the Administration plans to refinance and modify up to 9 million mortgages. Absent meaningful input from Treasury, it's difficult to calculate the all-in cost of the fore-

[399] Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* ((June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

closure mitigation programs to both the taxpayers, and the holders of residential mortgages, investors in securitized mortgage obligations, other investors and mortgage servicers (which I refer to as the "financial community").

For example, under a HAMP modification the mortgage lender bears the cost of reducing each participant's monthly mortgage payment to 38 percent of DTI (the participant's debt-to-income), and the lender and the government share the cost of reducing the participant's monthly mortgage payment from 38 percent to 31 percent of DTI. The Panel's report notes that monthly principal and interest payments are reduced on average by $598—from $1554 to $956—following a HAMP modification. If you run the numbers over 12 months per year and for 4 million modifications, the annual cost equals approximately $29 billion. Over a five-year period the (non-discounted) cost equals approximately $145 billion. By adding, say, $9,000 of incentive payments for 4 million modifications the total all-in gross cost to the taxpayers and the financial community increases by $36 billion to approximately $181 billion ($145 billion, plus $36 billion-non-discounted). If, instead, the Administration elects to modify 9 million mortgages the total all-in gross cost to the taxpayers and the financial community jumps to approximately $407 billion (non-discounted). To these estimates must be added the billions of dollars already allocated to Fannie Mae and Freddie Mac as well as the write-offs already taken by private sector mortgage lenders, holders of securitized debt and servicers. These amounts reflect back-of-the-envelope estimates of gross costs and must be considered along with Professor White's cost-benefit testimony (discussed below) and the analysis of other experts. If the Administration promotes aggressive principal reduction, negative equity abatement and second lien programs, the estimates may, however, materially understate the all-in gross costs to the taxpayers and the financial community.

Based upon the Panel's report, it's difficult to determine how much of this cost will fall to the taxpayers and how much will be borne by the mortgage holders under the DTI formula. It is troubling that the Administration has made little effort to disclose the all-in cost of these programs to the taxpayers and the financial community. Did Treasury roll-out the MHA program with its promise of refinancing or modifying up to 9 million mortgages without providing a realistic estimate of the cost of the program to the taxpayers and the financial community?[400] Will Treasury commit to limit MHA to $50 billion of TARP funds?

4. Repaid TARP Funds Available for Foreclosure Mitigation

Although the HAMP program is presently limited to $50 billion of TARP funds, I am not aware of any constraint on the Secretary from allocating additional TARP funds to MHA or any other existing or future foreclosure mitigation efforts. Since the Secretary interprets TARP as a "revolving facility" and given the likelihood that he will extend TARP to October 31, 2010, it's possible that a

[400] Any attempt to quantify the total costs and expenses that may be incurred in restructuring mortgage loans should consider the following: (i) fees paid to servicers, attorneys, appraisers, surveyors, title companies and accountants, (ii) principal reductions, (iii) interest rate reductions, (iv) second lien reductions, (v) negative equity reductions, and the like.

substantial portion of the $700 billion TARP facility could be directed to foreclosure mitigation efforts. The MHA and the HAMP—Home Affordable Modification Program—and HARP—Home Affordable Refinancing Program—programs are subject to unilateral modification pursuant to which Treasury may restructure the programs to the detriment of the taxpayers. In addition, Treasury may introduce new programs that are funded in whole or in part by TARP. Along similar lines, it was recently reported that the Administration is close to committing up to $35 billion to state and local housing authorities to provide mortgages to low- and moderate- income families.[401] It's important to note again that CBO will most likely assign a 100 percent taxpayer subsidy rate to any new or expanded foreclosure mitigation programs thereby acknowledging the vast transfer of taxpayer funds from the taxpayers who meet their monthly mortgage and rental payments to those who do not.

5. Treasury Should Disclose the All-In Cost of the Foreclosure Mitigation Plans

In order to better appreciate the total all-in costs of the Administration's various foreclosure mitigation efforts, and to compensate for the Panel's gaps in oversight, I request that the Administration promptly provide the taxpayers with a thorough and fully transparent analysis of the following matters:

- the total amount of funds the Administration has advanced and committed to advance under its various foreclosure mitigation efforts (including, without limitation, under MHA, HAMP and HARP, the second lien programs, as well as the programs adopted by Fannie Mae and Freddie Mac);
- the total amount of funds the Administration reasonably expects to advance and commit to advance over the next five years under all of its present and anticipated foreclosure mitigation efforts; and
- the total anticipated costs to all financial institutions and other mortgage holders and servicers under all of the Administration's present and anticipated foreclosure mitigation efforts.

Like the recently completed "stress tests" conducted by Treasury and other financial regulators with respect to bank capital adequacy, the Administration should calculate the foregoing estimates under a "more adverse" scenario (i.e., where conditions materially deteriorate) as well as under current conditions. It is also imperative that the valuation models adopted by Treasury employ reasonable input assumptions and methodologies and make no effort to skew the results to the high or low range of estimates.

The analysis should acknowledge the extent to which the Administration's foreclosure mitigation efforts may create capital shortfalls within the financial community. It's somewhat ironic that at the same time the Administration is encouraging financial institutions and mortgage holders to boost their foreclosure mitigation efforts by restructuring home loans and writing down loan portfolios, the Administration is considering a new round of bailouts for the

[401] Deborah Solomon, *$35 Billion Slated for Local Housing* Wall Street Journal (Sept. 28, 2009) (online at online.wsj.com/article/SB125409967771945213.html).

financial community.[402] Since money is fungible it's not unreasonable to conclude that the Administration may be in effect reimbursing—with taxpayer sourced funds—financial institutions that adopt and follow the Administration's foreclosure mitigation policies.

One key function of effective oversight is to determine if Treasury will be able to achieve its stated goals for the stated price—the refinancing or modification of up to 9 million mortgage loans for $75 billion. It's not possible to accomplish this task without a better understanding of the anticipated all-in cost of the several foreclosure mitigation programs.

6. Analysis by the Panel and Professor Alan M. White

In prior reports the Panel has retained the services of nationally recognized academics to value, for example, warrants issued to Treasury under the Capital Purchase Program as well as toxic assets held by banks and other financial institutions. In preparing the October report, I recommended that the Panel again retain the services of top-tier academics and other professionals to estimate the total cost to the taxpayers and the financial community of the various housing foreclosure mitigation plans and proposals including, without limitation, all refinancing, modification and second lien plans and proposals. Although the Panel's efforts do not reflect the same robust analysis undertaken in prior reports, I wish to thank Professor Alan M. White for his paper on the "potential costs and benefits" of the HAMP program.

In calculating the total cost of each mortgage modification to the taxpayers, Professor White concludes:

> To summarize, the total cost of the borrower, servicer and investor incentive payments for first and second mortgage HAMP payments is projected to be in the range of $16,000 to $21,000 average per first mortgage modification, including both successful and unsuccessful modifications. In other words, the cost per successful modification will be higher. Treasury should be in a position to report on actual per-modification costs by November or December, when several months of permanent modification data have been collected and some initial redefault statistics can be calculated.

Since these numbers apparently include up to $9,000 of incentive payments it appears that the total cost to the taxpayers of all interest rate and principal adjustments is approximately $10,000 per modification, or approximately $2,000 per year ($167 per month) for the full five-year HAMP modification period. Perhaps this is correct, but I question whether mortgage loans may be successfully modified at such a relatively modest cost to the taxpayers under the HAMP program. It appears that Professor White did not independently calculate these amounts, but, instead, generally relied upon estimates provided by Treasury. It is unclear what methodology Treasury employed except, perhaps, to divide the $50 billion of TARP funds initially allocated to HAMP by 2.5 million modifications, or $20,000 per mortgage modification. Such approach, al-

[402] Daniel Wagner, *Fresh Bailouts for Smaller Banks Being Weighed*, The Observer (Sept. 25, 2009) (online at hosted.ap.org/dynamic/stories/U/__US__SMALL__BANKS__BAILOUT).

though suggested by Professor White, hardly reflects the application of rigorous scientific methodology.

Professor White also expressly notes the effectiveness of non-subsidized voluntary foreclosure mitigation when he states:

> Nevertheless, there is convincing evidence that successful modifications avoided substantial losses, while requiring only very modest curtailment of investor income. In fact, the typical voluntary modification in the 2007–2008 period involved no cancellation of principal debt, or of past-due interest, but instead consisted of combining a capitalization of past-due interest with a temporary (three to five year) reduction in the current interest rate. Foreclosures, on the other hand, are resulting in losses of 50% or more, i.e. upwards of $124,000 on the mean $212,000 mortgage in default.

Significantly, he also quantifies the overall benefit of voluntary foreclosure mitigation to investors by concluding:

> The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60% or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more. Two million modifications with a 60% success rate could produce $160 billion in avoided losses, an amount that would go directly to the value of the toxic mortgage-backed securities that have frozen credit markets and destabilized banks.

If this is indeed the case, then why is it not in the best interest of each mortgage holder to modify the mortgage loans in its portfolio? Why would a mortgage holder risk breaching its fiduciary duties to its investor group by foreclosing on mortgaged property instead of restructuring the underlying loans? Why should the taxpayers subsidize the restructuring of mortgage loans—whether through the HAMP program or otherwise—if the mortgage holders may independent of such subsidy realize a net gain of approximately $80,000 per loan by voluntarily restructuring their distressed mortgage loans?

Professor White and the Panel seem to imply that without taxpayer-funded subsidies the mortgage servicers would be economically disinclined to modify distressed mortgage loans because of unfavorable terms included in typical pooling and servicing agreements—the contracts pursuant to which servicers discharge their duties to mortgage holders. Professor White writes:

> While modification can often result in a better investor return than foreclosure, modification requires "high-touch" individualized account work by servicers for which they are not normally paid under existing securitization contracts (pooling and servicing agreements or "PSA"s.)[403] Servicer payment levels were established by contracts that last the life of the mortgage pools. Servicers of subprime

[403] Standard & Poor's, *Servicer Evaluation Spotlight Report* (July 2009) (online at www2.standardandpoors.com/spf/pdf/media/SE__Spotlight__July09.pdf).

> mortgages agreed to compensation of 50 basis points, or 0.5% from interest payments, plus late fees and other servicing fees collected from borrowers, based on conditions that existed prior to the crisis, when defaulted mortgages constituted a small percentage of a typical portfolio. At present, many subprime and alt-A pools have delinquencies and defaults in excess of 50% of the pool. The incentive payments under HAMP can be thought of as a way to correct this past contracting failure.
>
> Because mortgage servicers are essentially contractors working for investors who now include the GSE's, the Federal Reserve and the Treasury, we can think of the incentive payments under HAMP as extra-contractual compensation for additional work that was not anticipated by the parties to the PSAs at the time of the contract.

Is the purpose of HAMP to bailout servicers from their "contracting failure" through the payment of "extra-contractual compensation"? The taxpayers should not be charged with such a responsibility and I am disappointed that the Administration, the Panel and Professor White would advocate such an approach. Notwithstanding the inappropriate complexity interjected into the foreclosure mitigation debate by the Administration, a solution appears relatively straightforward. If, as Professor White suggests, mortgage holders stand to realize a net gain of approximately $80,000 from restructuring each mortgage loan instead of foreclosing on the underlying property, the mortgage holders themselves should undertake to subsidize the "contracting failure" of their servicers out of such gains. I appreciate that mortgage holders may not wish to remit additional fees to their servicers, but, between mortgage holders and the taxpayers, why should the taxpayers—through TARP or otherwise—bear such burden? The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP and HARP programs (with a reasonable expectation that additional funds may be forthcoming), has arguably caused them to abandon their market oriented response to the atypical rate of mortgage defaults in favor of seeking hand-outs from the government. It's difficult to fault mortgage holders and servicers for their rational behavior in accepting bailout funds that may enhance the overall return to their investors.

In addition, Professor White dismisses the importance of considering future decisions homeowners and others will make when entering into risky contracts when there is a perceived safety net. It is insufficient simply to say, "moral hazard from HAMP modifications is unlikely to play a significant role in borrower defaults," as viewed through the prism of "the cost of losses on mortgages that would otherwise perform but for the borrower's decision to default in order to benefit from the program." I appreciate that Professor White provides a definition to support his analysis, but it is an inadequate premise for such a sweeping conclusion. If the objective of the Administration's MHA program is to correct failures in the housing market so as to provide economic stabilization, then any estimate of total cost provided by Professor White or Treasury would by definition fail to consider the additional costs that will no doubt ensue when homeowners are saved from mortgage contracts they would not otherwise be able to shoulder without a government backstop. It would also exclude future risk-taking behavior that may necessitate future interventions. The MHA program in effect incorporates the failed policy of "implicit guarantee"—notoriously exploited by Fannie Mae and Freddie Mac—into yet another aspect of federal housing policy. By disregarding the distinct moral hazard risk, the MHA encourages speculation in the residential real estate market with its adverse bubble generating consequences.

7. Response to March Report on Foreclosures

In my response to the March Panel report, I commented on several aspects of the housing crisis that I felt were omitted or not thoroughly described by the Panel. These include further contributing causes, the universe of individuals in distress, the realized and unrealized costs of loan modification programs, and additional alternatives to government-subsidized foreclosure mitigation efforts.[404]

Below is a summary of some of the key points I discussed in response that are relevant to the current discussion on foreclosure mitigation:

- Foreclosure relief should be centered around borrowers in a fair, responsible, and taxpayer-friendly way.
- Policymakers should take care to avoid the trap of creating further market distortions that disrupt the law of supply and demand, which is designed to ensure that qualified borrowers have reliable access to mortgage products suitable to their needs.
- Government involvement in housing markets has already created significant disruptions, chiefly through highly accommodative monetary policy; federal policies designed to expand home ownership; the congressionally-granted duopoly status of housing GSEs, Fannie Mae and Freddie Mac; an anti-competitive government-sanctioned credit rating oligopoly; and mandates of certain policies and underwriting standards based on factors other than risk.[405]
- As the 2009 deficit reaches an estimated $1.6 trillion, evaluation of foreclosure plans must consider the all-in costs as well as the extraordinary federal assistance that has been provided in response to the financial crisis.
- The Panel should practice caution in estimating the redefault rates that will occur three months to a year after participation in the MHA—Making Home Affordable—program. Historical, yearly

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[404] Representative Jeb Hensarling, *Foreclosure Crisis: Working Toward a Solution, Additional View by Representative Jeb Hensarling*, (Mar. 9, 2009) (online at cop-senate.gov/documents/cop–030609-report-view-hensarling.pdf).

[405] One of the difficulties that some borrowers are facing has been the general federal objective of enabling and encouraging people to buy homes that were too expensive for them to otherwise afford. In a perfect world, the laws of supply and demand would be the fundamental driver of our mortgage markets, with qualified borrowers having reliable access to suitable mortgage products that best fit their needs. Yet, in reality, the cost of home ownership has in many places so thoroughly outpaced the ability of borrowers to afford a home that the government has chosen to intervene with various initiatives to defray parts of the cost of a mortgage. That intervention has taken many forms—affordable housing programs, federal FHA mortgage insurance, tax credits and deductions, interest rate policies, etc.—as part of a concerted effort to increase homeownership. For almost a decade, those efforts succeeded, pushing homeownership rates steadily up from 1994 through their all-time high in 2004. That increase in demand, in turn, contributed to a corresponding increase in home prices, which rose from the mid–1990s until hitting their peak in 2006. Yet those price increases created a cycle of government intervention—home price appreciation made homes less affordable, which in turn spurred further government efforts to defray more of their cost—and the involvement of the federal government in our housing markets only grew deeper.

data show that redefault rates have been over 50 percent on modified loans.[406]

• Foreclosure rates are concentrated in specific states and areas, making one-size-fits all programs even more difficult to execute.

• It is important to remember that the number of individuals in mortgage distress reaches beyond individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs.[407]

• Distinct from a moral hazard question there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble. In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair.[408]

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[406] Office of the Comptroller of the Currency and Office of Thrift Supervision *Mortgage Metric Report, First Quarter 2009* (online at www.occ.treas.gov/ftp/release/2009–77a.pdf) . See chart on page 7, which conveys a re-default rate of over 50 percent based on the most recent data available.

[407] These "life event" affected borrowers are noteworthy because relatively few object to efforts to find achievable solutions for trying to help keep these distressed borrowers in their current residences whenever possible. Similarly, another sympathetic group of distressed borrowers involves people who were legitimate victims of blatant manipulation or outright fraud by unscrupulous lenders who pressured them into homes they could not afford. To many, those legitimate victims are certainly equally deserving of assistance. Of course, such borrowers do have the added burden proving that they were indeed victims of actual wrongdoing. However, they also have a potential remedy of pursuing legal action against fraudulent lenders, an option which is not available to others.

If the universe of individuals in mortgage distress included only borrowers from "life event" and fraud victims groups, the task of crafting an acceptable government-subsidized foreclosure mitigation plan would be much easier. However, the number of individuals in mortgage distress stretches far beyond those groups to include a much larger section of people who, for a wide variety of reasons, are no longer paying their mortgage on time. While certainly not an exhaustive list, that larger group includes:

• people who took out large loans to purchase more house than they could have reasonably expected to afford;

• borrowers who lied about their income, occupancy, or committed other instances of mortgage fraud;

• speculators who purchased multiple houses for their expected value appreciation rather than a place to live;

• individuals who decided to select an exotic mortgage loan with fewer upfront costs, lower monthly payments, or reduced documentation requirements;

• borrowers who took advantage of refinance loans to strip much or all of the equity out of their house to finance other purchases;

• those who simply made bad choices by incorrectly gambling on the market or overestimating their readiness for homeownership; and

• borrowers who have made a rational economic decision and, given their particular circumstance, it no longer makes sense to them to continue paying their mortgage.

Borrowers who fall into those categories are much less sympathetic in the eyes of many, and attempting to develop a government-subsidized foreclosure mitigation plan to assist them will inevitably raise significant moral hazard questions for policymakers.

A fundamental measure of the effectiveness of a foreclosure mitigation program is what steps the program has taken to sort those risky borrowers out from their more deserving counterparts to avoid the moral hazard of rewarding people or their bad behavior.

[408] After all, why should a person be forced to pay for their neighbor's mortgages when he or she is struggling to pay his or her own mortgages and other bills? To many people, this question is the most important aspect of the public policy debate. Given the massive direct taxpayer costs that have already been incurred through TARP and the potential costs that could be incurred through the assorted credit facilities and monetary policy actions of the Federal Reserve, I believe that it is difficult to justify asking the taxpayers to shoulder an even greater financial burden from yet another government foreclosure mitigation program that might not work.

• Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple mitigation programs that do not amplify taxpayer risk or require government mandates.

• See the following link for my full response to the Panel's March report: http://cop.senate.gov/documents/cop–030609-reportview-hensarling.pdf.

8. Foreclosures and Macroeconomic Recovery

Indeed, the housing market is still on shaky ground and homeowners face the turmoil of potential waves of foreclosures. Although there are signs of life in the market—such as upward movement in housing starts and nationwide home values—unpredictable existing home sales figures [409] and continued increases in delinquencies and foreclosures mean underlying indicators are still problematic. Mortgage interest rates remain at low levels by historical standards, although much of this may be intertwined with the Federal Reserve's program to purchase up to $1.25 trillion in agency mortgage-backed securities. The future may be even more ominous for housing prices and recovery if concerns are realized about "shadow inventory," a term for the millions of homes that are waiting to hit the market either because they are in foreclosure or for other reasons.[410]

Even still, housing indicators cannot be studied in isolation. The best insurance policy to protect homeowners from foreclosure is having a job, and the best assurance of job security is the engine of economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. The Blue Chip Consensus and other forecasters predict that unemployment will hit 10 percent in 2010. Although a less-than-expected GDP drop for the second quarter is a positive signal, the path to economic recovery is expected to be sluggish, and further dragged down by record debt and deficit levels.[411]

Whether or not MHA will lead to economic stabilization or prevent further disruptions, two integral mandates of EESA, is open for debate. The Panel's report suggests that the housing market "has been at the center of the economic crisis, and until it is stabilized, the economy as a whole will remain in turmoil." It is undisputed that the collapse of housing prices ignited the financial crisis, which was linked to the risky undertakings of multiple players: government, lenders, borrowers and investors. Yet even if macroeconomic recovery were irrevocably dependent on the revival of the housing market—likely, the reverse is true—can this revival be spurred by a large-scale loan modification program that has committed $75 billion in taxpayer funding?

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[409] Sara Murray, *Existing Home Sales Dropped In August,* Wall Street Journal (September 24, 2009) (online at online.wsj.com/article/SB125379520447237461.html#mod=WSJ__hps__LEFTWhatsNews).

[410] Jody Shenn, *"Housing Crash to Resume on 7 Million Foreclosures, Amherst Says,* Bloomberg News (September 23, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aw6__gqc0EKKg).

[411] U.S. Office of Management and Budget, *Mid-Session Review, Economic Assumptions* (August 2009) (online at www.gpoaccess.gov/USbudget/fy09/pdf/09msr.pdf).

9. The Panel's Mandate With Respect to Taxpayer Protection

Taxpayer protection is a guiding principle of EESA interwoven throughout the legislation, including for foreclosure mitigation efforts. I recommend that Treasury and the Panel define in measurable terms what is at stake—the costs and the benefits—for taxpayers in implementing the MHA plan.

EESA gives the Panel a clear duty to provide information on foreclosure mitigation programs, but with the following caveat. Reports must include:

> The effectiveness of foreclosure mitigation efforts and the effectiveness of the program from the standpoint of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.[412] [Emphasis added.]

While the Executive Summary of the Panel's report discusses this mandate as if it were a major theme of the paper, the analysis that follows does not give due credence to taxpayer considerations. Professor White's analysis does not assuage concerns about taxpayer protection—in fact, it aggravates them by suggesting there is actually a $50 billion ceiling on HAMP costs and that investors stand to gain at the taxpayers' expense.

The Panel's March report applies eight criteria in its evaluation of loan modification programs, which is also included in the most recent report:

- Will the plan result in modifications that create affordable monthly payments?
- Does the plan deal with negative equity?
- Does the plan address junior mortgages?
- Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?
- Does the plan counteract mortgage servicer incentives not to engage in modifications?
- Does the plan provide adequate outreach to homeowners?
- Can the plan be scaled up quickly to deal with millions of mortgages?
- Will the plan have widespread participation by lenders and servicers?

While these are valid criteria, the list, which serves as the lynchpin for both the March and October reports, does not include taxpayer considerations. The Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs.[413] (It is reasonable to assume that the entire $75 billion program carries a 100 percent subsidy rate.) It also shows that the five-year MHA is not surprisingly a major driving force behind the extension of TARP costs well into 2013.[414] MHA is not an investment with a realizable return in the same sense as other TARP

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[412] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343 § 125.

[413] U.S. Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

[414] U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2009) (online at www.cbo.gov/ftpdocs/85xx/doc8565/08-23-Update07.pdf).

programs, such as the Capital Purchase Program, where at least a portion of the outlays are expected to be recouped, and many with interest. The $75 billion program funds the array of incentive payments to servicers and lenders/investors who participate in the MHA program. It will not be returned to the Treasury general fund as the program winds down, so in a sense, it is equivalent to a $50 billion increase in deficits as the debt level reaches $12.3 trillion by 2013.[415]

According to Treasury's program description for MHA, the payments to servicers, lenders and homeowners are as follows:[416]

- Treasury will share with the lender/investor the cost of reductions in monthly payments from 38 percent DTI to 31 percent DTI.
- Servicers that modify loans according to the guidelines will receive an up-front fee of $1,000 for each modification, plus "pay for success" fees on still-performing loans of $1,000 per year.
- Homeowners who make their payments on time are eligible for up to $1,000 of principal reduction payments each year for up to five years.
- The program will provide one-time bonus incentive payments of $1,500 to lender/investors and $500 to servicers for modifications made while a borrower is still current on mortgage payments.
- The program will include incentives for extinguishing second liens on loans modified under this program.[417]
- No payments will be made under the program to the lender/investor, servicer, or borrower unless and until the servicer has first entered into the program agreements with Treasury's financial agent.
- Similar incentives will be paid for Hope for Homeowner refinances.

Taxpayers and the Panel should demand no less than complete transparency and accountability of funds. If no financing will be repaid from the MHA program, Treasury must provide its own assessment of how it measures benefits and risks for all taxpayers, not just for participants of the program. For example, even were the program to work for a select group of homeowners, it may be working against the majority who shoulder the tax burden and make mortgage payments on time. If evidence can be provided to the contrary, it must be plausible enough to diminish the risks of entering into a $50 billion investment where direct funding will not be recovered.

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[415] U.S. Office of Management and Budget, *Mid-Session Review,* (August 2009) (online at www.gpoaccess.gov/usbudget/fy10/pdf/10msr.pdf).

[416] U.S. Department of Treasury, *Making Home Affordable: Summary of Guidelines,* (March 4, 2009) (online at www.treas.gov/press/releases/reports/guidelines_summary.pdf).

[417] Announced in April, MHA's second lien program offers the following:

Pay-for-Success Incentives for Servicers and Borrowers:

The Second Lien Program will have a pay-for-success structure similar to the first lien modification program, aligning incentives to reduce homeowner payments in a way most cost effective for taxpayers.

Servicers can be paid *$500 up-front* for a successful modification and then success payments of *$250 per year for three years,* as long as the modified first loan remains current.

Borrowers can receive success payments of up to *$250 per year for as many as five years.* These payments will be applied to pay down principal on the first mortgage, helping to build the borrower's equity in the home. U.S. Department of Treasury, *Making Home Affordable: Program Update* (April 28, 2009) (online at www.financialstability.gov/docs/042809SecondLienFactSheet.pdf).

10. Making Home Affordable Program—Making Sense of the Data

On March 4, 2009, the Department of the Treasury released a program description of "Making Home Affordable," or MHA, the Administration's multi-tiered plan to prevent foreclosure for "at-risk" homeowners. When it was announced, the advertised goal was to "offer assistance to as many as 7 to 9 million homeowners." [418] Based on the information provided so far by Treasury, only murky conclusions can be reached about the program's progress, especially when taxpayer funds spent or committed are considered.[419]

11. Home Affordable Modification Program

The Administration committed $75 billion—$50 billion of TARP financing and $25 billion of "Housing and Economic Recovery Act of 2008" (HERA) [420] financing—to the HAMP program, a loan modification program aimed at reducing monthly interest payments for 3 to 4 million homeowners who are either close to defaulting on payments or are already delinquent. The TARP funds used for HAMP are solely for private-label loans, although Fannie Mae and Freddie Mac both have major roles in the program, with Fannie Mae serving as the "administrator" and Freddie Mac serving as the "compliance agent." HAMP uses HERA funding for loans owned or guaranteed by Fannie Mae or Freddie Mac.

Treasury has released some metrics on HAMP in its August Monthly Progress Report.[421] According to these data, just over 360,000, 3-month trial modifications have begun. Assistant Secretary Allison testified at a Senate Banking Committee hearing on September 24, 2009, that only about 1,800 of the total modifications have become permanent.[422] Treasury believes, however, that the HAMP program will exceed the newly-set target of 500,000 trial modifications by November.[423]

The jury is still out on whether the program will ultimately accomplish its goals, how long this may take and what it will cost. There are many factors at work, including the ability of servicers

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[418] U.S. Department of Treasury, *Making Home Affordable: Updated Detailed Program Description* (March 4, 2009) (online at www.ustreas.gov/press/releases/reports/housing_fact_sheet.pdf).

[419] On October 8, GAO released its latest report on TARP, which included a table of Treasury's actions in response to major GAO recommendations. As an example, one recommendation is to "Institute a system to routinely review and update key assumptions and projections about the housing market and the behavior of mortgage holders, borrowers, and servicers that underlie Treasury's projection of the number of borrowers whose loans are likely to be modified under HAMP and revise the projection as necessary in order to assess the program's effectiveness and structure."

It is worth nothing that the status of all of the GAO recommendations for HAMP is either "not implemented" or "partially implemented."

Government Accountability Office, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges* (October 2009) (GAO–10–16) (online at www.gao.gov/new.items/d1016.pdf).

[420] Pub. L. No. 110–289.

[421] U.S. Department of Treasury, *Troubled Assets Relief Program: Monthly Progress Report—August 2009* (September 10, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/105areport_082009.pdf).

[422] Senate Committee on Banking, Housing and Urban Affairs, Testimony of U.S. Treasury Department Assistant Treasury Secretary, Herb Allison, *EESA: One Year Later* (September 24, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction= Hearings.Hearing&Hearing_ID=ff78e881-372e-41e3-915d-e4d5a93da22d).

[423] This target has only recently been announced and was not part of the MHA program's launch in March 2009.

to perform the necessary "counseling" role, the willingness of homeowners to participate, and much larger external forces such as the labor market. Borrowers may enter into the trial modification process only to be denied based on criteria like debt-to-income levels. Even those whose modifications become permanent for several months may redefault because of job loss, "back-end" debt such as credit card obligations (which is not factored into debt-to-income calculations) or other reasons that make mortgage payments unsustainable.

Were all 360,000 trial modifications to succeed in not only lowering payments but also in staving off foreclosure, Treasury is still a long way from its goal of assisting 3 to 4 million homeowners. Treasury's latest transaction report on TARP indicates that a maximum of $27 billion out of $50 billion in authority has been used for incentive payments, although it is unclear how this corresponds to metrics on completed modifications.[424] Assistant Secretary Allison has said that "very little" of the funds have been spent, but unless the proper data are provided to link funds spent or committed to loan modifications that have become permanent, much is open to interpretation.

Are we to assume that the outcome of committing $27 billion in taxpayer funding has only yielded at most 360,000 loan modifications? If not, what are we to assume? Will Treasury commit additional TARP funds beyond the $50 billion in order to make the program work as advertised? Will it use the essentially boundless[425] HERA authority as a back-door approach to financing expansions in HAMP? What other measures may be taken to deliver on the promise to reach millions of homeowners? Will Treasury adjust the criteria?

12. Home Affordable Refinance Program for Agency Mortgages

A separate platform of the Administration's MHA plan, the "Home Affordable Refinance Program," or (HARP), targets up to 4 to 5 million homeowners with loans owned or guaranteed by Fannie Mae and Freddie Mac. Homeowners can qualify who are up to 125 percent "underwater" on their mortgages—a situation where the borrower owes more on the loan than the value of the home—but must have a track record of making payments on time. Although Treasury has given assurances that no TARP funds will be intermingled with HARP,[426] the program's ability to prevent millions of foreclosures and stabilize the housing market is nevertheless intertwined with the TARP-funded program, HAMP, and must be considered by the Panel.

The HERA statute established the authority for Treasury to purchase preferred stock in Fannie Mae and Freddie Mac in amounts it or the GSEs deem necessary, providing the two housing companies with equity injections. Although this authority technically expires on December 31, 2009, Treasury may increase the limit to

[424] U.S. Department of the Treasury, *Troubled Assets Relief Program: Transactions Report for Period Ending September 18, 2009* (Sept. 22, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report__09222009.pdf).

[425] See following section.

[426] Letter from Assistant Treasury Secretary for Financial Stability Herb Allison, to the Honorable Jeb Hensarling, United States Congressman (Sept. 14, 2009).

any level through the expiration date. Part of the Administration's housing plan involves doubling the size of the purchase agreements from a maximum of $200 billion to a maximum of $400 billion,[427] which did not require Congressional approval or budgetary review. So far, Fannie and Freddie have drawn $95.6 billion in capital from the agreements.[428]

The powers granted by the HERA statute have been used to fund the Administration's loan modification efforts through HAMP and HARP, but there is no clear way to segregate the costs of new housing policies from other expenditures as well as from losses on Fannie's or Freddie's books of business (discussed further in later section). Very few metrics on the success of HARP have been released to date. Fannie Mae and Freddie Mac executives testified before this Panel on September 24, 2009, and although they did speak to the number of total refinances performed by the agencies this year, they did not discuss HARP specifically. Treasury and the GSEs should be held accountable for making any loan modification program or refinancing program as transparent as possible, since it involves a minimum of $25 billion of taxpayer dollars and there is no clear way to understand whether or not programs supporting Fannie- or Freddie-guaranteed mortgages will require additional funds.

13. Issues Enlisting Servicer Support of MHA

The Panel's October report spotlights several obstacles to launching a massive loan modification program. One is whether HAMP servicers will have the capacity or expertise to successfully carry it out. Another involves whether they can handle the volume of modifications MHA creates in a profitable manner.

What the report does not emphasize is simply whether or not the program can provide appropriate incentives that will outweigh both the risk of borrower redefault as well as what may be the enhanced return from foreclosure and sale to a solvent buyer. Along these lines the report seems to accept without comment the need for government sponsored-foreclosure mitigation programs and generally disregards private sector efforts without sufficient analysis. It's quite often in the best interest of private sector servicers and mortgage holders to restructure distressed loans but I am concerned that the confusing array of government sponsored programs may have chilled many creative private sector initiatives. Instead of being proactive, private sector servicers and mortgage holders may have been enticed to sit on their hands and wait for higher fees, servicing payments, and interest and principal subsidies courtesy of HAMP or some other government-sponsored foreclosure mitigation program. Without these programs and the expectation of future subsidies, servicers and mortgage holders would have had little choice but to implement independent private sector programs. It's ironic, but all the false starts with HAMP and the other gov-

[427] U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description,* (Mar. 4, 2009) (online at www.ustreas.gov/press/releases/reports/housing_fact_sheet.pdf).

[428] Fannie Mae, Second Quarter 2009 Form 10-Q (Aug. 6, 2009) (online at phx.corporate-ir.net/phoenix.zhtml?c=108360&p=irol-secQuarterly&control_SelectGroup=Quarterly%20Filings); Freddie Mac, Second Quarter 2009 Form 10-Q (Aug. 7, 2009) (ir.10kwizard.com/files.php?source=1372&welc_next=1&XCOMP=0&fg=23).

ernment programs may have exacerbated the foreclosure mitigation process by keeping private sector servicers and mortgage holders on the sidelines waiting on a better deal from the government.[429]

Such behavior is entirely rational if the servicers and mortgage holders have a reasonable expectation that Treasury will dedicate more TARP or other funds to foreclosure mitigation efforts. Since Treasury asserts that repaid TARP funds may be recycled to new programs it's not unrealistic to expect that Treasury will offer more favorable programs to servicers and mortgage holders in the relatively near future. Since servicers perform their duties pursuant to complex contractual arrangements that mandate they maximize the return to the mortgage holders, it's quite possible that servicers risk default under their contracts if they fail to capture the greatest subsidy rate offered by the government. In addition, servicers themselves may of course benefit by waiting for enhanced payments. The only way to convince servicers and mortgage holders that they will not forego additional governmental largess is for Treasury to state clearly that the MHA program will not be expanded and that no additional TARP or government funds will be allocated to foreclosure mitigation efforts.

In addition, there is simply no way of knowing whether or not larger institutions receiving TARP funds were pressured into participating in government-supported loan modification programs against the best interest of other performance goals (which would have the potential to restrict credit extension elsewhere). Bank of America and Wells Fargo, receiving a combined $70 billion in TARP aid, stepped up the rate of loan modifications as part of MHA by 60 percent in August after receiving criticism from lawmakers for "not doing enough." [430]

14. Bankruptcy Cram Down

The report makes several supportive references to substituting federal bankruptcy judges for the traditional role performed by servicers and mortgage holders in loan modifications. Under these plans bankruptcy judges would be granted the unilateral right to change—that is, cram down—the terms of mortgage loans over the express objections of mortgage holders as part of a bankruptcy proceeding. Although Congress rejected a bankruptcy cram down proposal a few months ago, I am troubled that the Panel continues to ignore the unintended consequences of such approach, especially the fee potential homeowners will be asked to pay due to enhanced risks to lenders of entering into mortgage contracts that could unilaterally be unwound. The Mortgage Bankers Association estimates that if bankruptcy cram down were to become law, mortgage rates would increase by approximately 1.50 percent resulting in annual additional mortgage payments of approximately $3,970, $3,346 and $2,989 for typical homeowners in California, Washington, D.C. and New York, respectively.[431] These phantom taxes will add to the in-

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[429] HOPE Now, a public-private foreclosure mitigation alliance in existence since 2007, for example, has performed as many as 140,000 loan modifications per month. Since HARP is a first stop for at-risk homeowners, programs like HOPE Now may be put on the back burner.

[430] Bloomberg, Banks Step Up Loan Modifications Under Obama Program (Sept. 9, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aDFdlC9CYQEQ).

[431] Mortgage Bankers Association, Stop the Bankruptcy Cram Down Resource Center (online at www.mortgagebankers.org/stopthecramdown) (accessed Oct. 8, 2009).

creasing burden borne by the vast majority of homeowners who meet their mortgage obligations each month. It seems profoundly unfair to ask these homeowners to subsidize the costs of any bankruptcy cram down plan. The bankruptcy cram down proposal would also adversely skew the typical rent v. buy analysis undertaken by individuals and families.

15. State Anti-Deficiency Laws and Bankruptcy Cram Down May Encourage Counterproductive Real Estate Speculation by Home Purchasers

An individual's or family's decision to rent or purchase a residence requires a thoughtful balancing of an array of economic factors. Renting provides flexibility with annual or even month-to-month rental obligations while purchasing requires a longer-term financial commitment. Rental payments are not tax deductible but mortgage interest expense and property taxes arising from an owned residence are deductible subject to limitations. Renting offers scant investment opportunity (absent long-term below market leases), yet home ownership often yields favorable inflation adjusted returns. In addition, beginning in the mid-1990s with the gradual relaxation of underwriting standards and due diligence analysis historically conducted by Fannie Mae, Freddie Mac, private mortgage lenders and securitizers, many renters were encouraged to opt in favor home ownership.

The seeming advantages of home ownership are nevertheless tempered by the nature of the contractual agreements most home purchasers undertake with their mortgage lender. While home purchasers may consider themselves "owners" of their homes they explicitly understand that if they fail to make their monthly principal and interest payments on a timely basis they run the distinct risk of losing the right to continue their ownership. Such an appreciation of economic reality requires little if any financial sophistication and few Americans would challenge the overall fairness or necessity of such consequences. From an historical perspective a substantial majority of individuals and families have made the rent v. buy decision with these factors in mind and, as such, have acted in a rational manner by not overextending their financial commitments.

Over the past several years, however, the rent v. buy decision process has been arguably altered as homeowners have become aware of the economic implications arising from applicable "anti-deficiency" and "single-action" laws and other rules adopted in many states that permit, if not indirectly encourage, homeowners to avoid their contractual mortgage obligations. In their basic form, anti-deficiency and single-action statutes limit the debt collection efforts that mortgage lenders may employ so as to render mortgage loans effectively non-recourse obligations to the borrowers. Absent these laws, mortgage lenders may sue their borrowers and receive enforceable judgments for any deficiency arising from the spread between the foreclosure sales price of the pledged collateral and the outstanding balance of the mortgage loan. As such, in jurisdictions where these laws do not apply, borrowers understand that by signing mortgage loans they are contractually responsible for the entire indebtedness even if the fair market value of their home materially drops in value. If anti-deficiency and single-action statutes are applicable, it is not implausible to argue that the laws convert mortgage contracts into put option agreements pursuant to which borrowers may elect to satisfy their monthly mortgage obligations so long as they hold equity in their homes, but walk away from—or put—their mortgage obligations to their mortgage holders with relative impunity if negative equity develops.

16. Homeowners React in a Rational Manner to Economic Incentives

These laws create significant moral hazard risks that will be exacerbated if Congress passes a cram down amendment to the bankruptcy code. With these laws in effect, the risk-reward mix underlying each mortgage and home equity loan will be bifurcated with lenders assuming substantially all of the risks regarding the underlying value of the mortgaged property and homeowners receiving substantially all of the rewards. These laws may have the unintended consequence of encouraging homeowners to reject their contractual responsibilities and service their mortgage obligations only when it's in their economic self-interest. Since option contracts are inherently more risky to lenders than traditional mortgage contracts, lenders may have little choice but to incorporate such risks into the interest rates and fees charged on mortgage loans. The Panel should refrain from suggesting that Congress enact legislation that encourages individuals and families to invest in the housing market for speculative purposes while permitting them to avoid their contractual obligations upon the occurrence of adverse market conditions.

It is worth noting that the decision of individuals and families to speculate in the housing market, while perhaps unwise, is not entirely irrational. While some may contend that the average consumer is too unskilled to comprehend seemingly sophisticated financial products, I would argue to the contrary. With anti-deficiency, single-action and, perhaps, bankruptcy cram down laws in effect it does not take a Ph.D. in corporate finance or an expert in bankruptcy law to appreciate that borrowers will receive the bulk of any equity appreciation while lenders will bear substantially all of the risk of loss arising from home mortgage loans. Most consumers are rational and react favorably to incentives that reward particular behavior. Providing economic and legal incentives that encourage inappropriate speculation in the housing market is unwise and fraught with adverse unintended consequences. That a bankruptcy cram down law could help re-inflate a housing bubble by encouraging reckless speculation and cause lenders to raise mortgage interest rates and fees justifies its rejection.

17. Shared Appreciation Rights and Equity Kickers Missing in Administration's Foreclosure Mitigation Programs at the Expense of Taxpayer Protection

It is my understanding that the foreclosure mitigation programs announced by Treasury do not provide Treasury or the mortgage lenders with the ability to participate in any subsequent appreciation in the fair market value of the properties that serve as collateral for the modified or refinanced mortgage loans. For example, a

$100,000, 6 percent home mortgage loan may be modified by reducing the principal to $90,000 and the interest rate to 5 percent. If the house securing the mortgage loan subsequently appreciates by, say, $25,000, the taxpayers and the mortgage lender who shared the cost of the mortgage modification will not benefit from any such increase in value. Such result seems inappropriate and particularly unfair to the taxpayers. By modifying the mortgage loan and avoiding foreclosure the taxpayers and the mortgage lender have provided a distinct and valuable financial benefit to the distressed homeowner which should be recouped to the extent of any subsequent appreciation in the value of the house securing the modified mortgage.

Homeowners should not receive a windfall at the expense of the taxpayers and the mortgage lenders and should graciously share any subsequent appreciation with those who suffered the economic loss from restructuring their distressed mortgage loans. Since one of Treasury's fundamental mandates is taxpayer protection, the incorporation of a shared appreciation right or equity kicker feature would appear appropriate.

18. Tremendous Federal Support of the Housing Market

Evaluation of a government-subsidized loan modification plan cannot occur in a vacuum as if in the context of a case study. Private capital has fled the housing market scene and we have seen recent, rapid growth in the government's share of the mortgage markets. This has yet to fully play out but is sure to have adverse consequences if continued crowding out private-sector participation. In addition, there are already extraordinary measures being taken not only by Treasury, but also by the Federal Reserve and others to provide stability in the housing sector. While there are short-term gains to such interventions, the longer-term hurdle of unwinding government support creates many challenges for returning to sustainable activity in the absence of such support.

19. Fannie, Freddie and FHA

In the market for new origination, Fannie, Freddie and the Federal Housing Authority (FHA) are the dominant forces, supporting 94 percent of mortgages.[432] Loans backed by Fannie and Freddie have grown from about 39 percent in 2006 to 72 percent in the first quarter of 2009.[433] FHA loans, requiring as little as 3.5 percent down, now account for 22 percent of market share, up from just 3 percent in 2006.[434] While Fannie and Freddie currently have an automatic line of credit to Treasury, there are reports that FHA may soon require a bailout (which the agency denies), as its reserve fund dwindles below the legal requirement.[435]

20. The Federal Reserve

The Federal Reserve has made an exceptional commitment to purchase up to $1.25 trillion in agency mortgage-backed securities,

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[432] Source: *Inside Mortgage Finance.* Data on mortgage origination by product as percentage of total Ex-HELOC, first quarter 2009.
[433] Source: *Inside Mortgage Finance.*
[434] Source: *Inside Mortgage Finance.*
[435] Alan Zibel, *Government Home Loan Agency Faces Cash Squeeze,* Associated Press (Sept. 18, 2009).

of which it has bought about $680 billion. Currently, the Fed buys around 80 percent of all new issuance, which is believed to play a significant role in keeping interest rates low. The Wall Street Journal estimates that the Fed MBS program has lowered spreads over Treasuries by about 70 basis points (so if the current mortgage interest rate is 5.2 percent, it estimates that without Fed purchases it would be around 5.7 percent).[436] Although Fed Chairman Ben Bernanke has indicated the central bank will be slowing its purchases, there are concerns about the effect slowing or stopping will have on rates.

21. Summary of Government Programs

In addition to crisis-oriented programs, there are multiple government initiatives that already facilitate mortgage credit and provide other types assistance to homeowners. Below is a table of major government actions and programs.

Interventions in the Mortgage Markets [437]	Description
The Federal Reserve	Commitment to purchase a total of $1.45 trillion of agency MBS and housing-agency bonds
	Use of Section 13(3) of Federal Reserve Act authority to provide FRBNY financing for Maiden Lane LLC, consisting of mortgage-related securities, commercial mortgage loans and associated hedges Bear Stearns
	Use of Section 13(3) to provide FRBNY financing for Maiden Lane II LLC, consisting of residential mortgage-backed securities from AIG
	Smaller-scale loan modification program for Maiden Lane LLC run by Blackrock and Wells Fargo
Fannie Mae and Freddie Mac [GSEs].	Guarantee mortgages in the secondary market so that investors will receive their expected principal and interest payments
	Put into conservatorship under the Federal Housing Finance Agency [FHFA] in September 2008
	Total combined portfolios of $5.46 trillion,[438] which includes mortgage-backed securities and other guarantees, as well as gross mortgage portfolios
	CBO brought Fannie and Freddie onto the budget and estimates they will cost taxpayers $390 billion over 10 years, with a $248 billion cost occurring at the time of conservatorship [439]
	Now represent 72 percent of the loan origination market [440]
Federal Housing Agency [FHA]	Provides mortgage insurance on loans made by private lenders
	Located in HUD; loans were typically for low-income, first-time homebuyers and minorities
	FHA now insures 5.3 million mortgages, and represents 22 percent of the loan origination market [441]
FDIC's IndyMac Program	The FDIC conducts a comprehensive program to provide loan modifications and other assistance to borrowers who have a first mortgage owned or securitized and serviced by IndyMac
	This program has served as one model for the Administration's MHA program
	The FDIC became the conservator of failed IndyMac bank and still holds roughly $11 billion in assets, many mortgage-related
Federal Home Loan [FHL] Bank System.	12 FHL Banks borrow funds in debt markets and provide loans to members
	Loans are typically collateralized by residential mortgage loans and government and agency securities
Veterans Affairs [VA]	VA guarantees housing loans for veterans and their families
United States Department of Agriculture [USDA] / Rural Development [RD].	USDA/RD guarantees loans for moderate-income individuals or households to purchase homes in rural areas.
Ginnie Mae	Corporation within HUD that guarantees MBS with the full faith of the government
	Guarantees 90% of FHA loans; 80% of Ginnie Mae's portfolio is made up of FHA loans

[436] Mark Gongloff, *Decision on Ending Housing Prop Can Wait,* The Wall Street Journal (Sept. 22, 2009) (online at online.wsj.com/article/SB125357555750029391.html).

Interventions in the Mortgage Markets [437]	Description
Additional HUD/FHA Programs, such as HOPE for Homeowners.	HOPE for Homeowners is an example of a HUD-run program that allows homeowners to refinance into an FHA mortgage, with certain restrictions on debt-to-income ratios and loan limits
	Borrowers pay a premium of 3% of the original mortgage amount and an annual premium of 1.5% of the outstanding mortgage amount
	Fannie and Freddie reimburse costs to FHA not covered by premiums
	HOPE has fallen significantly short of the goal of renegotiating mortgage terms for 400,000 homeowners (100 served)
Community Reinvestment Act	Passed in 1977 to prevent ''redlining,'' a term that refers to the practice of denying loans to neighborhoods considered to be higher economic risks, by mandating that banks to lend to the communities where they take deposits
	The current CRA law requires the OCC, OTS, Federal Reserve and FDIC as regulators to assess each bank and thrift's lending records pursuant to CRA and to apply this in evaluating applications for charters, mergers, acquisitions and expansions
Mortgage Interest Tax Deduction.	Allows all homeowners to deduct interest paid on mortgages on income tax returns
$8,000 First-time Homebuyer Credit.	Refundable tax credit equal to 10 percent of the purchase price up to a maximum of $8,000
	Only eligible for single taxpayers with incomes up to $75,000 and married couples with combined incomes up to $150,000
	Passed as part of the ''American Recovery and Reinvestment Act of 2009,'' but extension currently being considered in Congress
Treatment of Capital Gains	Exemption from paying capital gains tax on the first $250,000 for individual filers ($500,000 for joint filers) of capital gains from the sale of a primary residence
Mortgage Revenue Bonds	State or local agencies issue tax-exempt bonds and use the proceeds to offer mortgages below the market interest rate for first-time homebuyers of certain income levels

[437] Some background provided by GAO, ''Analysis of Options for Revising the Housing Enterprises' Long-term Structures,'' September 2009.
[438] Fannie Mae, *Monthly Summary* (July 2009) (online at www.fanniemae.com/ir/pdf/monthly/2009/073109.pdf;jsessionid=B4Q4GWTY555N3J2FECISFGA);, Freddie Mac, *Monthly Summary* (July 2009) (online at www.freddiemac.com/investors/volsum/pdf/0709mvs.pdf).
[439] Congressional Budget Office, The Budget and Economic Outlook: An Update (August 2009) (online at www.cbo.gov/ftpdocs/85xx/doc8565/08-23-Update07.pdf).
[440] Source: Inside Mortgage Finance
[441] Source: *Inside Mortgage Finance*.

22. Role of Fannie Mae and Freddie Mac in Administration's Housing Plan

The Administration's MHA plan aims to lower mortgage rates by "strengthening confidence in Fannie Mae and Freddie Mac."[442] "Strengthening confidence" seems to mean increasing the size of the taxpayer's commitment in Fannie and Freddie significantly by $200 billion to $400 billion (not to mention their portfolio limits), as well as making the GSEs a centerpiece of housing policy. As mentioned, Fannie and Freddie have already received $95.6 billion in capital injections from Treasury to fill "holes" in their balance sheets where liabilities exceed assets.[443] The companies are required to pay annual interest of 10 percent on the injections, although this amounts to a sum that is larger than the historical profits made by the GSEs (during years where they made profits).

Just as a history of bad management decisions did not preclude GM and Chrysler from receiving TARP funds, the same is true of Fannie Mae and Freddie Mac. It should be noted that their financial insolvency materialized after years of mismanagement—and after years of enjoying the gold seal of the government's implicit guarantee. As I wrote in the March addendum to the Panel's report:

[442] U.S. Department of Treasury, *Making Home Affordable: Updated Detailed Program Description* (March 4, 2009) (online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).
[443] Through September 30, 2009.

> Fannie and Freddie exploited their congressionally-granted charters to borrow money at discounted rates. They dominated the entire secondary mortgage market, wildly inflated their balance sheets and personally enriched their executives. Because market participants long understood that this government created duopoly was implicitly (and, now, explicitly) backed by the federal government, investors and underwriters chose to believe that if Fannie or Freddie touched something, it was safe, sound, secure, and most importantly "sanctioned" by the government. The results of those misperceptions have had a devastating impact on our entire economy. Given Fannie and Freddie's market dominance, it should come as little surprise that once they dipped into the subprime and Alt-A markets, lenders quickly followed suit. In 1995, HUD authorized Fannie and Freddie to purchase subprime securities that included loans to low-income borrowers and allowed the GSEs to receive credit for those loans toward their mandatory affordable housing goals. Fannie and Freddie readily complied, and as a result, subprime and near-prime loans jumped from 9 percent of securitized mortgages in 2001 to 40 percent in 2006. In 2004 alone, Fannie and Freddie purchased $175 billion in subprime mortgage securities, which accounted for 44 percent of the market that year. Then, from 2005 through 2007, the two GSEs purchased approximately $1 trillion in subprime and Alt-A loans, and Fannie's acquisitions of mortgages with less than 10-percent down payments almost tripled. As a result, the market share of conventional mortgages dropped from 78.8 percent in 2003 to 50.1 percent by 2007 with a corresponding increase in subprime and Alt-A loans from 10.1 percent to 32.7 percent over the same period. These non-traditional loan products, on which Fannie and Freddie so heavily gambled as their congressional supporters encouraged them to "roll the dice a little bit more," now constitute many of the same non-performing loans which have contributed to our current foreclosure troubles.[444]

In addition, GAO also noted in a September 2009 report:

> While housing finance may have derived some benefits from the enterprises' activities over the years, GAO, federal regulators, researchers, and others long have argued that the enterprises had financial incentives to engage in risky business practices to strengthen their profitability partly because of the financial benefits derived from the implied federal guarantee on their financial obligations.[445]

In September 2008, Treasury put Fannie Mae and Freddie Mac into conservatorship under the Federal Housing Finance Agency

[444] See Congressional Oversight Panel, *March Oversight Report: Foreclosure Crisis: Working Toward a Solution*, "Additional View by Representative Jeb Hensarling," (online at cop.senate.gov/documents/cop-030609-report-view-hensarling.pdf).

[445] Government Accountability Office, *Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, September 10, 2009 (online at www.gao.gov/new.items/d09782.pdf).

[FHFA], effectively making taxpayers liable for their portfolios which now total about $5.46 trillion (including mortgage-backed securities and other guarantees, as well as gross mortgage portfolios.[446] According to CBO, the current estimate of the cost of bringing Fannie's and Freddie's books of business onto the federal budget is $390 billion.[447]

In addition, the GSEs' support of Treasury's MHA loan modification program is expected to amplify the risk of an already-leveraged taxpayer investment. The following excerpt from Freddie's second quarter 2009 filing to the SEC mentions the dire financial situation, the probable need for additional Treasury capital, and the possible negative effect on financials caused by the MHA program:

> We expect a variety of factors will place downward pressure on our financial results in future periods, and could cause us to incur GAAP net losses. Key factors include the potential for continued deterioration in the housing market, which could increase credit-related expenses and security impairments, adverse changes in interest rates and spreads, which could result in mark-to-market losses, and our efforts under the MHA Program and other government initiatives, some of which are expected to have an adverse impact on our financial results. We believe that the recent modest home price improvements were largely seasonal, and expect home price declines in future periods. Consequently, our provisions for credit losses will likely remain high during the remainder of 2009 and increase above the level recognized in the second quarter. To the extent we incur GAAP net losses in future periods, we will likely need to take additional draws under the Purchase Agreement. In addition, due to the substantial dividend obligation on the senior preferred stock, we expect to continue to record net losses attributable to common stockholders in future periods."[448]

GAO has also discussed specifically the impact to the GSEs of participation in HAMP and HARP:

> While these federal initiatives were designed to benefit homebuyers, in recent financial filings, both Freddie Mac and Fannie Mae have stated that the initiative to offer refinancing and loan modifications to at-risk borrowers could have substantial and adverse financial consequences for them. For example, Freddie Mac stated that the costs associated with large numbers of its servicers and borrowers participating in loan-modification programs may be substantial and could conflict with the objective of minimizing

[446] Fannie Mae, *Monthly Summary*, July 2009 (online at www.fanniemae.com/ir/pdf/monthly/2009/073109.pdf;jsessionid=GZALNHE45QP0LJ2FECISFGI); Freddie Mac, *Monthly Summary*, July 2009 (online at www.freddiemac.com/investors/volsum/pdf/0709mvs.pdf).

[447] Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2009 (online at www.cbo.gov/doc.cfm?index=10521). The Administration still considers Fannie Mae and Freddie Mac to be off-budget entities.

[448] Federal Home Loan Mortgage Corporation, *Form 10–Q to the Securities and Exchange Commission*, quarterly period ending June 30, 2009 (online at www.freddiemac.com/investors/er/pdf/10q__2q09.pdf).

> the costs associated with the conservatorships. Freddie Mac further stated that loss-mitigation programs, such as loan modifications, can increase expenses due to the costs associated with contacting eligible borrowers and processing loan modifications. Additionally, Freddie Mac stated that loan modifications involve significant concessions to borrowers who are behind in their mortgage payment, and that modified loans may return to delinquent status due to the severity of economic conditions affecting such borrowers. Fannie Mae also has stated that, while the impact of recent initiatives to assist homeowners is difficult to predict, the participation of large numbers of its servicers and borrowers could increase the enterprise's costs substantially. According to Fannie Mae, the programs could have a materially adverse effect on its business, financial condition, and net worth.[449]

Since the GSEs are now under the conservatorship of the Federal Housing Finance Agency [FHFA], their concerns are now officially the taxpayers' concerns. Any losses the GSEs experience through MHA programs should be a carefully considered part of a cost-benefit analysis.

In addition, as noted in the March report additional views, for well over twenty years, federal policy has promoted lending and borrowing to expand homeownership, through incentives such as the home mortgage interest tax exclusion, the FHA, discretionary HUD spending programs, and the Community Reinvestment Act [CRA]. CRA is an example of a program with the best of intentions having adverse, unintended consequences on exactly the population it hopes to serve. It was initially authorized to prevent "redlining," a term that refers to the practice of denying loans to neighborhoods considered to be higher economic risks, by mandating banks lend to the communities where they take deposits. Since its passage into law in 1977, however, CRA has advanced at least two undesirable outcomes: (1) some financial institutions completely avoided doing business in neighborhoods and restricted even low-risk forms of credit, and (2) many institutions went the other way and relaxed underwriting standards to meet CRA guidelines, thus opening the door to certain risky products that have contributed to the problem of foreclosures. These lax underwriting standards spread to Fannie and Freddie and ultimately to the private sector as the role of the GSEs morphed from that of a liquidity provider to a promoter of home ownership.

23. Questions for Fannie Mae and Freddie Mac

Representatives of Fannie Mae and Freddie Mac testified before the Panel at a hearing on foreclosure mitigation held in Philadelphia on September 24, 2009. I asked the following questions for the record to Fannie Mae and Freddie Mac and await their response.

[449] Government Accountability Office, *Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, September 2009 (online at www.gao.gov/new.items/d09782.pdf).

Fannie Mae

1. Fannie Mae has so far received approximately $44.9 billion in equity injections from Treasury through the Preferred Share Purchase Agreements authorized by the Housing and Economic Recovery Act of 2008 [HERA].

Will Fannie Mae request additional funds from Treasury through this program?

Will Treasury's commitment to purchase preferred shares in Fannie Mae increase beyond the $200 billion limit announced in March 2009?

2. How much of the funding that Fannie Mae has received through HERA-authorized injections has been spent on the Administration's "Making Home Affordable" plan?

How much has Fannie Mae committed from HERA-authorized funds for "Making Home Affordable" efforts?

Specifically, how much of this funding has been and will be used by Fannie Mae for the Administration's "Home Affordable Modification Program?"

How much of this funding has been and will be used by Fannie Mae for the Administration's "Home Affordable Refinance Program?"

3. What is the average cost of modifying a home loan under "Home Affordable Modification Program," according to Fannie Mae's most recent data?

Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

If you do not have these data, please explain why not.

4. What is the average cost of refinancing a home loan under "Home Affordable Refinance Program," according to Fannie Mae's most recent data?

Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

If you do not have these data, please explain why not.

5. In general, how do you expect Fannie Mae's participation in the "Making Home Affordable" plan to affect financials for the next quarter?

What about for the next year?

6. The Federal Reserve has already purchased about $860 billion of its $1.25 trillion commitment to buy Fannie Mae and Freddie Mac-guaranteed mortgage-backed securities.[450] To put it in context, right now, the Federal Reserve buys the lion's share of all new issuance, which is somewhere around 80 percent.

If the Federal Reserve stops purchasing Fannie Mae's mortgage-backed securities then who will purchase the securities and at what price?

Has the Federal Reserve or Fannie Mae attempted to sell these securities to private sector participants and, if so, what has been the response?

Have any significant purchasers of U.S. Treasuries asked the Federal Reserve to cap its purchases of these securities?

[450] Federal Reserve, *Press Release* (Sept. 23, 2009) (online atwww.federalreserve.gov/newsevents/press/monetary/20090923a.htm).

Freddie Mac

1. Freddie Mac has so far received approximately $50.7 billion in equity injections from Treasury through the Preferred Share Purchase Agreements authorized by the Housing and Economic Recovery Act of 2008 [HERA].

Will Freddie Mac request additional funds from Treasury through this program?

Will Treasury's commitment to purchase preferred shares in Freddie Mac increase beyond the $200 billion limit announced in March 2009?

2. How much of the funding that Freddie Mac has received through HERA-authorized injections has been spent on the Administration's "Making Home Affordable" plan?

How much has Freddie Mac committed from HERA-authorized funds for "Making Home Affordable" efforts?

Specifically, how much of this funding has been and will be used by Freddie Mac for the Administration's "Home Affordable Modification Program?"

How much of this funding has been and will be used by Freddie Mac for the Administration's "Home Affordable Refinance Program?"

3. What is the average cost of modifying a home loan under "Home Affordable Modification Program," according to Freddie Mac's most recent data?

Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

If you do not have these data, please explain why not.

4. What is the average cost of refinancing a home loan under "Home Affordable Refinance Program," according to Freddie Mac's most recent data?

Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

If you do not have these data, please explain why not.

5. In general, how do you expect Freddie Mac's participation in the "Making Home Affordable" plan to affect financials for the next quarter?

What about for the next year?

6. The Federal Reserve has already purchased about 860 billion of its 1.25 trillion-dollar commitment to buy Fannie Mae and Freddie Mac-guaranteed mortgage-backed securities.[451] To put it in context, right now, the Federal Reserve buys the lion's share of all new issuance, which is somewhere around 80 percent.

If the Federal Reserve stops purchasing Freddie Mac's mortgage-backed securities then, who will purchase the securities and at what price?

Has the Federal Reserve or Freddie Mac attempted to sell these securities to private sector participants and, if so, what has been the response?

Have any significant purchasers of U.S. Treasuries asked the Federal Reserve to cap its purchases of these securities?

[451] Board of Governors of the Federal Reserve System, *Press Release* (Sept. 23, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/20090923a.htm).

24. Net Present Value Analysis and the Risk of Redefault

The redefault rate is a key input cited by the Panel and used by servicers to calculate the all-in net present value of electing to pursue a loan modification versus a foreclosure. It goes without saying that the chance of waves of redefaults occurring enhances significantly the risk of the Administration's $75 billion MHA program. The self-cure rate, which refers to the ability for borrowers to catch up on loan payments without assistance, is also an important factor in NPV calculations. Understandably, under the current economic conditions where unemployment is supposed to reach at least 10 percent, self-cure rates will be likely be lower than under conventional circumstances. The Panel's report disputes the findings of a paper released by the Federal Reserve Bank of Boston, which cites self-cure rates of 25 to 30 percent, and supports a recent study showing self-cure rates of closer to between 4.3 percent and 6.6 percent. The reality is that homeowners' ability to heal themselves is largely a function of economic growth and the opportunities it affords. Another reality not mentioned is the fact that homeowners may choose not to self-cure because of the attractiveness of a government-sponsored loan modification plan.

The Panel also calls into question the average redefault rate of up to 50 percent cited by the Federal Reserve Bank of Boston, which, is also approximately the level of redefaults computed by the OCC and OTS one year after a loan modification has been performed.[452] It should be stressed that we simply do not have enough evidence to show that the longer-term risk of redefault on a loan modified by MHA is still not very high. This is true by virtue of Assistant Secretary Allison's statement that only 1,800 permanent modifications—that is, those that have survived the minimum three-month threshold to become permanent—have been put in place. Only time will tell if this very costly investment will serve the number of homeowners the Administration has assured without requiring additional taxpayer funds. Since the data are ambiguous at best, it should not be affirmed by the Panel that redefault and self-cure rates are conclusively within one narrow range or another in order to make the case that government-sponsored loan modification is a more attractive option.

25. The Issue of Fairness

The Panel's report states, "Devoting attention and resources to moral sorting is at odds with the goal of maximizing the macroeconomic impact of foreclosure prevention. Trying to sort out the deserving from the undeserving on any sort of moral criteria means that foreclosure prevention efforts will be delayed and have a narrower scope. Moreover, in other cases where the federal government extended assistance under TARP—such as to banks and auto manufacturers—no attempt was made to sort between entities deserving and not deserving assistance. No inquiry was made as to which investors in these entities knowingly and willingly assumed the risks of the entities"Insolvency.' "

[452] Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, First Quarter 2009* (online at www.occ.treas.gov/ftp/release/2009–77a.pdf) (June 2009). MHA has not been in operation for a year and it is not possible to obtain yearly re-default data.

In fact, this distinction could be crucial to long-term stabilization. Programs that create moral hazard by giving no consideration to the rightful, necessary link between risk and responsibility could potentially create additional housing "bubbles" and result in greater threats to stability.

It goes without saying that moral hazard has already played out for some financial institutions that received billions in TARP funds, even if capital was initially deployed with an eye to prevent a global economic meltdown. The federal safety net was spread wide as many who exhibited irresponsible behavior were deemed "too big to fail" for systemic risk reasons, qualifying them for protected status. This is a legacy the banking system and the government will have to deal with for a long time, even if taxpayers are receiving repayments in full with interest from Capital Purchase Plan recipients. The Panel's report implies that two moral hazards make a right, and encourages an even wider number of homeowners to be bailed out from what could be their own bad decisions simply because it is the fair treatment. I question if the approximately 95 percent of taxpayers who satisfy their rental and mortgage obligation each month would consider such bailouts fair particularly if they result in higher tax rates and mortgage interests costs. The irony is that although the report concludes a moral judgment should be immaterial when doling out taxpayer money, a comparison of homeowners to Wall Street companies is in itself a moral comparison used to justify subsidization of mortgage payments.

By advocating a policy of additional bailouts the Panel has chosen to burden a substantial majority of the taxpayers with yet another subsidy-based program. It is difficult for me to appreciate the inherent fairness or appropriateness of such an approach.

26. Mortgage Fraud and Abuse

I am concerned that the Panel mentions fraud in its report only to assert how broad publication of mortgage schemes may deter homeowners from participating in MHA. SIGTARP, which has been actively monitoring fraud, waste and abuse, is currently in the process of conducting an audit on the "Making Home Affordable" program which will focus on reviewing its current status and the challenges it faces. This oversight body is sure to take cases of fraud very seriously. Widespread scams are a serious issue—the FBI estimates annual losses from mortgage fraud to be between $4 and $6 billion—and one whose significance should not be undermined in exchange for more aggressive outreach to borrowers. Homeowners must be presented with all of the facts on the serious risk of fraud as well as given the encouragement to perform due diligence on all of the options at their disposal if they cannot meet mortgage payments.

27. Conclusions and Recommendations for an Oversight Plan and the Adoption of a COP Budget

A fair reading of the Panel's majority report and my dissent leads to one conclusion—HAMP and the Administration's other foreclosure mitigation efforts to date have been a failure. The Administration's opaque foreclosure mitigation effort has assisted only a small number of homeowners while drawing billions of involuntary taxpayer dollars into a black hole.

While the Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs, instead of focusing its attention on taxpayer protection and oversight, the Panel's majority report implies that the Administration should commit additional taxpayer funds in hopes of helping distressed homeowners—both deserving and undeserving—with a taxpayer subsidized rescue.

While there may be some positive signals in our economy, recovery remains in a precarious position. Unemployment will hit 10 percent in 2010, if not this year. This is unfortunate because the best foreclosure mitigation program is a job, and the best assurance of job security is economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. Without a robust macroeconomic recovery the housing market will continue to languish and any policy that forestalls such recovery will by necessity lead to more foreclosures.

Regardless of whether one believes foreclosure mitigation can truly work, taxpayers who are struggling to pay their own mortgage should not be forced to bail out their neighbors through such an inefficient and transparency-deficient program. Both the Administration and the Panel's majority appear to prioritize good intentions and wishful thinking over taxpayer protection.

To date, despite the commitment of some $27 billion,[453] only about 1,800 underwater homeowners have received a permanent modification of their mortgage. If the Administration's goal of subsidizing up to 9 million home mortgage refinancings and modifications is met, the cost to the taxpayers will almost surely exceed by a material amount the $75 billion already allocated to the Making Home Affordable program, none of it recoverable.

Taxpayers deserve a better return on their investment than what they are set to receive from AIG, Chrysler, GM and the Administration's flawed foreclosure mitigation efforts.

Professor Alan M. White, an expert retained by the Panel, notes in a paper attached to the Panel's report: "The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60 percent or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more."

Taxpayers—through TARP or otherwise—should not be required to subsidize mortgage holders or servicers when foreclosure mitigation efforts appear in many cases to be in their own economic best interests. The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP and HARP programs (with a reasonable expectation that additional funds may be forthcoming), has arguably caused them to abandon their market oriented response to the atypical rate of mortgage defaults in favor of seeking assistance from the government.

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[453] U.S. Department of the Treasury, *Troubled Assets Relief Program Transactions Report* (Oct. 6, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_10062009.pdf). The commitment cited is as defined by the current "Total Cap" for the Home Affordable Modification Program, $27,247,320,000.

Any foreclosure mitigation effort must appear fair and reasonable to the American taxpayers. It is important to remember that the number of individuals in mortgage distress reaches beyond individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs.[454] Distinct from a moral hazard question, there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble.

In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is: "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair.[455]

Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple mitigation programs that do not amplify taxpayer risk or require government mandates. Subsidized loan refinancing and modification programs may provide relief for a select group of homeowners, but they work against the majority who shoulder the tax burden and make mortgage payments on time.

28. Oversight Plan

As I have stressed before, I believe the Panel continues to make the mistake of putting policy objectives above transparent and critical oversight. The October report on foreclosure issues is a strong example of this. I am again dismayed that the Panel's current release is driven by an approach that appears to favor an expansion of government-subsidized foreclosure mitigation plans over consideration of taxpayer protections and prudent supervision.

The Panel has yet to present and adopt an oversight plan. Until one is made official, reports and actions taken will not adhere to standard guidelines. I recommend the following be considered by the Panel.

The EESA statute requires COP to accomplish the following, through regular reports:

- Oversee Treasury's TARP-related actions and use of authority

[454] These "life event" affected borrowers are noteworthy because relatively few object to efforts to find achievable solutions for trying to help keep these distressed borrowers in their current residences whenever possible. Similarly, another sympathetic group of distressed borrowers involves people who were legitimate victims of blatant manipulation or outright fraud by unscrupulous lenders who pressured them into homes they could not afford. To many, those legitimate victims are certainly equally deserving of assistance. Of course, such borrowers do have the added burden proving that they were indeed victims of actual wrongdoing. However, they also have a potential remedy of pursuing legal action against fraudulent lenders, an option which is not available to others.

[455] After all, why should a person be forced to pay for their neighbor's mortgages when he or she is struggling to pay his or her own mortgages and other bills? To many people, this question is the most important aspect of the public policy debate. Given the massive direct taxpayer costs that have already been incurred through TARP and the potential costs that could be incurred through the assorted credit facilities and monetary policy actions of the Federal Reserve, I believe that it is difficult to justify asking the taxpayers to shoulder an even greater financial burden from yet another government foreclosure mitigation program that might not work.

- Assess the impact to stabilization of financial markets and institutions of TARP spending
- Evaluate the extent to which TARP information released adds to transparency
- Ensure effective foreclosure mitigation efforts in light of minimizing long-term taxpayer costs and maximizing taxpayer benefits.

In adherence to this mandate, the Panel should consider adopting the following standards of oversight:

- Analyzing programs proposed by Treasury to determine if they are properly designed for their intended purpose
- Determining if the investment of TARP funds in each program is permitted under EESA
- Determining if the programs are being properly implemented in a reasonable, transparent, accountable and objective manner
- Determining if taxpayers are being protected
- Determining the success or failure of the programs based upon reasonable, transparent, accountable and objective metrics
- Analyzing Treasury's exit strategy with respect to each investment of TARP funds
- Analyzing the corporate governance policies and procedures implemented by Treasury with respect to each investment of TARP funds
- Holding regular public hearings with the Secretary and other senior Treasury officials
- Holding regular public hearings with TARP recipients with special care taken to invite major recipients to testify
- Keeping a record of all invitations to testify and responses
- Determining how TARP recipients invest and deploy their TARP funds
- Reporting the results to the taxpayers in a clear and concise manner
- Avoiding public policy recommendations in the reports released by the Panel
- Conducting the Panel's oversight activities in the most reasonable, transparent, accountable and objective manner with measurable standards that hold Treasury accountable, without limitation, for the statutory mandate of EESA that taxpayer protection is an upmost priority
- Conducting the internal operations of the Panel in the most reasonable, transparent, accountable and objective manner.

29. Adoption of a Budget and Disclosure of Other Matters by COP

The Panel has a taxpayer protection based statutory obligation to oversee the funds committed and spent by Treasury on all TARP programs, as well as to ensure that there is complete transparency and accountability in Treasury's reporting practices. Taxpayers should demand no less than full disclosure of how the Panel's own operations are financed. It has been one year since the Panel's inception and a budget has yet to be produced. The Panel should release a budget on continuing operations by November 1, and should make available detailed information on past uses of all funds received for Panel activities by such date. These reports should disclose in sufficient detail all operating expenses and other amounts incurred or paid by the Panel for, without limitation, rent, IT, travel, services, utilities, equipment as well as the salary and other compensation paid to all Panel employees, interns, consultants, advisors, experts and independent contractors. In order to ensure the absence of any conflict of interest, the Panel should disclose the names and affiliations of all such consultants, advisors, experts and independent contractors and the terms of the written or oral agreements through which they render advice or counsel to the Panel (even if they are not compensated for their services). The Panel should update these matters each month and disclose the results on its website.

In quarterly reports to Congress, not only does SIGTARP publish its statutory mandate and how well the organization follows EESA requirements, it also provides a detailed budget and information on hired personnel. SIGTARP must formally request funds from Treasury for any amounts beyond the initial EESA grant. In the July report to Congress, its budget includes a specific breakdown of financing requested for staff, rent, services, transportation, advisory, etc.[456]

SIGTARP also discloses on its website the contracts that it enters into with outside vendors and other Governmental agencies to obtain goods and services,[457] a description of its senior staff,[458] and its organizational chart.[459] Although the Panel's website contains a blog,[460] it does not disclose any of the other items.

The EESA statute calls on the Panel's Chair to present a statement of expenses to the Treasury Secretary. Treasury then transfers funding for reimbursement of the Panel into separate, equal accounts in both the House of Representatives and the Senate.[461] Since the Panel runs on the fuel of taxpayer dollars, it should be held to task for creating budgets and statements of operations that are fully transparent to the public, especially as Treasury makes the decision of whether or not to extend TARP—and thus the Panel's oversight and costs—beyond December 31, 2009.

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456 SIGTARP, *Quarterly Report to Congress*, at 26 (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf).

457 See Special Inspector General for the Troubled Asset Relief Program (SIGTARP) website (online at sigtarp.gov/about_procure.shtml).

458 See Special Inspector General for the Troubled Asset Relief Program (SIGTARP) website (online at sigtarp.gov/about_staff.shtml).

459 See Special Inspector General for the Troubled Asset Relief Program (SIGTARP) website (online at sigtarp.gov/about_org.shtml).

460 See the Congressional Oversight Panel's website (online at cop.senate.gov/blog/).

461 Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110–343, § 125:

FUNDING FOR EXPENSES.—

(1) AUTHORIZATION OF APPROPRIATIONS.—There is authorized to be appropriated to the Oversight Panel such sums as may be necessary for any fiscal year, half of which shall be derived from the applicable account of the House of Representatives, and half of which shall be derived from the contingent fund of the Senate.

(2) REIMBURSEMENT OF AMOUNTS.—An amount equal to the expenses of the Oversight Panel shall be promptly transferred by the Secretary, from time to time upon the presentment of a statement of such expenses by the Chairperson of the Oversight Panel, from funds made available to the Secretary under this Act to the applicable fund of the House of Representatives and the contingent fund of the Senate, as appropriate, as reimbursement for amounts.

C. Paul Atkins

The October Report of the Panel regarding mortgage foreclosure mitigation marks yet another commendable effort by the staff and the Panel to treat a complex area of the economy in a short amount of time. The October Report analyzes great deal of information and helpfully cites a wealth of resources and studies. I salute the staff and my colleagues for the hard work represented by the report. Unfortunately, I cannot join in supporting the October Report because of its extraneous discussions and opinions unrelated to TARP.

Congress has charged this Panel with overseeing a $700 billion program that was enacted in a hurry with much discretion placed in the Executive. Congress understandably was sensitive to the opportunity of departure from legislative intent and potential for improper activity that this situation presents. Thus, Congress formed not only this Panel but also an office of a special inspector general, independent of Treasury, to oversee the program, provide transparency, and ensure accountability to Congress and to the taxpayers. That unusual level of oversight reflects the concern of Members of Congress regarding the unusual nature of the program itself and its political sensitivity.

The October Report contains some commentary and recommendations that depart from the oversight role of this Panel and, I believe, detract from the overall effectiveness of the report's message. Congress empowered this Panel to watch over the Treasury Department's use of the authority granted under the Emergency Economic Stabilization Act. If the Treasury's efforts at implementing TARP in general or in particular areas are inchoate, unavailing, wasteful, illegal, or corrupt, it is our job to report on those problems and seek their correction.

On the other hand, it is not our role gratuitously to offer advice or comment on additional legislation, matters of behavioral economics, or academic studies. Consequently, it is entirely appropriate for our report to analyze the HAMP and HARP programs and judge them against the Administration's rhetoric regarding them. I applaud the staff's seeking input regarding costs and benefits. I view this research as a good basis for further public debate. From our observations and research, we are well positioned to offer advice as to needed adjustments to increase efficiency and responsiveness from what we have learned in the field or from public comment. We do not need to deal extensively with speculation as to the effects of negative equity, the desirability of a program of principal reduction, or legislative empowerment of bankruptcy judges to "cramdown" changes to mortgages. We might point out areas for additional academic research that we or policymakers might find helpful in the future, but we should not use the report as a means to challenge legitimate studies, such as a Federal Reserve Bank of Boston Working Paper discussed in the report, where we do not have sufficient time or expertise to do so.

Moreover, sweeping conclusions regarding the proper allocation of taxpayer resources are not within our purview. We are not policymakers and do not have the benefit of budget studies, knowledge of budgeting history, or advantage of debate regarding budgetary alternatives and priorities to make value judgments as between programs. Since government resources ultimately come from the taxpayers, government must be sensitive to prudent and moral use of taxpayer funds. In our role, we see only the matter and program before us. Thus, the report's venturing into speculation regarding the purpose of foreclosure mitigation and making value judgments regarding spending taxpayer money, including the statement that "[d]evoting attention and resources to moral sorting [as between "deserving" mortgagors and deadbeats or speculators] is at odds with the goal of maximizing the macroeconomic impact of foreclosure prevention," is inappropriate. Moral sorting is inherent in a legislator's consideration of support or opposition to legislation. To ignore it invites citizen cynicism and taxpayer outrage, which inevitably will be registered at the ballot box. Despite the report's casual treatment of this subject, I have confidence that Members of Congress will be extremely wary of adopting this report's view thereof.

My concern with the "market stability" argument to "prevent" foreclosures is that the policies are aimed at essentially seeking to support prices at an artificially high level. We have had a very large economic bubble in the housing sector, and a bubble's consequences are the misallocation of resources. The market—meaning people—needs to find the true level of prices according to supply and demand. This is easily seen in the residential housing market, where deals are closed or fall apart, often on the basis of relatively small amounts of money. Government intervention only prolongs the uncertainty and the eventual day of reckoning. But, there is also the forgotten person in the attempt to support prices. When the government uses taxpayer resources, with various justifications, to try to influence supply, the selling homeowner gets the artificially high price. However, what happens to the buyer who unwittingly pays a higher price than he otherwise might have paid in a more transparent marketplace? When the prices ultimately find equilibrium, and they settle lower despite the government's efforts, has the government helped to perpetrate a deception on the unwitting buyer who paid the artificially high price?

The report makes the assertion that there was no moral sorting as between good and bad financial institutions in the Treasury's use of TARP funds under the Capital Purchase Program and other programs and, thus, that there should be no need to judge between homeowners in providing direct assistance. The difference, however, is that the taxpayer has lent money to the various financial institutions with an expectation that the money will be returned. The propriety of that can be debated, but Congress at least had the expectation that TARP funds would be repaid with dividends, interest, and proceeds from sale of warrants and stock. As Congressman Hensarling points out in his accompanying statement, the Congressional Budget Office views funds spent for foreclosure mitigation as a subsidy, with no expectation of being repaid. For these efforts that entail millions of individual cases, it is best left to private parties and judges to sort out the issues to ensure some sort of accountability, not another grand entitlement program funded by the taxpayer that discounts legitimate concerns of propriety of subsidies and moral hazard.

In this vein, Judge Annette M. Rizzo of the Pennsylvania Court of Common Pleas, featured in our hearing on September 24th in Philadelphia, seems to have forged a positive atmosphere of mediation and dialogue that enhances communication between mortgagors and mortgagees. In many cases, the process has helped to forestall foreclosures, for the benefit of both parties. Sometimes, as Judge Rizzo forthrightly stated, foreclosure is unavoidable and contracts must be enforced. In this sense, the report also disappoints in its seeming approbation of "innovative" measures taken by various states that in some cases are arbitrary interference with contracts in the name of foreclosure "prevention" rather than "mitigation." The government should not be in the business of preventing parties to a contract from enforcing that contract, barring cases of fraud or other illegitimate factors.

With respect to mortgage foreclosure mitigation, it is relatively easy to focus on only one side of the relationship as between mortgagor and mortgagee, because the former is currently the party in the weaker position and seeks assistance. However, ours is a legal system of transparency, due process, respect of private property rights, and enforceability of contract. This rule of law separates the United States from banana republics and has created a favorable investment climate that has attracted capital from around the world to be invested here. That has created jobs and built our economy.

The best policy to minimize foreclosures is for the U.S. government to create an environment conducive to saving and investment, including tax and regulatory policy, that encourages entrepreneurs to start businesses (the sector of business activity that creates the most jobs) and existing businesses to expand. The best mitigation of mortgage foreclosures is a job. Subsidies are inherently unfair, inefficient, expensive, and complicated. With soaring unemployment in the United States, focusing on creating a good environment for saving and investment becomes the most important action that the Administration can take.

SECTION THREE: CORRESPONDENCE WITH TREASURY UPDATE

On behalf of the Panel, Chair Elizabeth Warren sent a letter on September 15, 2009,[462] to Secretary of the Treasury Timothy Geithner requesting Treasury's inputs and formulae for the stress tests. The letter further requests answers to questions regarding how actual quarterly bank loss rates have differed from Treasury stress test estimates. The Panel has not received a response from Secretary Geithner.

[462] See Appendix I of this report, *infra*.

SECTION FOUR: TARP UPDATES SINCE LAST REPORT

A. TARP Repayment

Since the Panel's prior report, additional banks have repaid their TARP investment under the Capital Purchase Program (CPP). A total of 39 banks have repaid their preferred stock TARP investment provided under the CPP to date. Of these banks, 24 have repurchased the warrants as well. Additionally, during the month of August, CPP participating banks paid $1.83 billion in dividends and $8.4 million in interest on Treasury investments.

B. CPP Monthly Lending Report

Treasury releases a monthly lending report showing loans outstanding at the top 22 CPP-recipient banks. The most recent report, issued on September 16, 2009, includes data up through the end of July 2009 and shows that CPP recipients had $4.24 trillion in loans outstanding as of July 2009. This represents a one percent decline in loans outstanding between the end of June and the end of July.

C. Public-Private Investment Program

On September 30, 2009, Treasury announced the initial closings of Public-Private Investment Funds (PPIFs) established under the Legacy Securities Public-Private Investment Program (PPIP). Two of the nine pre-qualified funds, Invesco Legacy Securities Master Fund, L.P. and UST/TCW Senior Mortgage Securities Fund, L.P. closed with a total of $1.13 billion of committed equity capital. Treasury has ten days from September 30, to provide matching equity funding. Each fund is eligible for additional debt financing of $2.26 billion, bringing the total resources of the fund to $4.52 billion.

Additionally, on October 5, 2009, Treasury announced the initial closings of three more pre-qualified funds managed by AllianceBernstein, LP, BlackRock, Inc., and Wellington Management Company, LLP, bringing the total number of closed funds to five, and the cumulative total committed equity and debt capital under the Legacy Securities program to $12.27 billion ($3.07 billion from the private sector and $9.2 billion from Treasury).

Treasury expects the four remaining funds to close by the end of October. Following an initial closing, each PPIF will have the opportunity for two more closings over the following six months to receive matching Treasury equity and debt financing, with a total Treasury equity and debt investment in all PPIFs equal to $30 billion ($40 billion including private sector capital).

Although the legacy loan program has been shelved by the FDIC for the time being, a pilot program to test the funding mechanism for the loan program was launched in mid-September. In a competitive bidding process, Residential Credit Solutions (RCS) won the right to participate in the pilot program. Under the pilot program, the FDIC will sell RCS half of the ownership interests in an LLC created to hold a portfolio of legacy "toxic" securities from Franklin Bank, SSB, a failed bank held in receivership by the FDIC. These legacy securities are comprised of a pool of residential mortgage loans with an unpaid principal balance of approximately $1.3 billion. At closing, RCS will pay the FDIC $64.2 million in cash for its 50 percent ownership interest in the LLC, and will issue a $727.7 million dollar FDIC-guaranteed note to the FDIC in exchange for the securities. The FDIC anticipates selling this note at a later date. The FDIC will analyze the results of this test sale to determine whether or not the legacy loans program is a feasible approach to removing troubled assets from bank balance sheets.

D. Making Home Affordable Program Monthly Servicer Performance Report

On October 8, 2009, Treasury released its third monthly Servicer Performance Report detailing the progress to date of the Making Home Affordable (MHA) loan modification program. The report discloses that as of September 30, 2009, 85 percent of mortgages are covered by a Home Affordable Modification Program (HAMP) participating servicer. The report also indicates that as of September 30, 2009, 487,081 trial loan modifications have occurred out of 757,955 trial plan offers extended.

E. Term Asset-Backed Securities Loan Facility (TALF)

As previously reported, the Federal Reserve Board and Treasury announced their approval of an extension to the Term Asset-Backed Securities Loan Facility (TALF). With the extension, the deadline for TALF lending against newly issued asset-backed securities (ABS) and legacy commercial mortgage-backed securities (CMBS) was extended from December 31, 2009 to March 31, 2010. Additionally, the deadline for TALF lending against newly issued CMBS was extended to June 30, 2010.

At the September 3, 2009 facility, $6.53 billion in loans to support the issuance of ABS collateralized by loans in the auto, credit card, equipment, property and casualty, small business, and student loan sectors were settled (though $6.54 billion in loans were requested). There were no requests supported by floorplan or residential mortgage loans. At the September 17, 2009 legacy CMBS facility, $1.35 billion in loans were settled (though $1.4 billion in loans were requested). Additionally, at the October 2, 2009 facility, $2.47 billion in loans to support the issuance of ABS collateralized by loans in the auto, credit card, equipment, floorplan, small business, and student loan sectors were requested. There were no requests supported by residential mortgage loans.

F. Bank of America Guarantee Termination Payment

On January 15, 2009, Treasury, the Federal Reserve, and the FDIC entered into a provisional agreement with Bank of America to guarantee a pool of assets valued at about $118 billion, which was predominately in the form of loans and securities backed by residential and commercial real estate loans acquired when Bank of America merged with Merrill Lynch. In exchange for this guarantee, the federal government was to receive $4 billion of preferred stock paying dividends at eight percent, warrants to purchase approximately $400 million of Bank of America stock, and a commitment fee. The provisional agreement was never finalized. On May

6, 2009, Bank of America notified the federal government that it wished to terminate the guarantee, and the parties negotiated a termination fee. On September 21, 2009, Bank of America agreed to pay $425 million to terminate the guarantee. Treasury received $276 million of the total fee, while the FDIC and the Federal Reserve received $92 million and $57 million, respectively. *See infra* note 505 (describing components of the termination fee). The government agreed to adjust the fee to reflect: (1) the downsizing of the guaranteed asset pool from $118 billion to $83 billion; and (2) the abbreviated time period (about four months) during which the guarantee was in effect.

G. Money Market Guarantee Program

On September 18, 2009, Treasury announced the end of its Guarantee Program for Money Market Funds. Treasury designed the program to stabilize markets after a large money market fund's announcement that its net asset value had fallen below $1 per share ("broke the buck") in the wake of the failure of Lehman Brothers in September of 2008. The program was initially established for a three-month period that could be extended through September 18, 2009. Since inception, Treasury has had no losses under the program and earned approximately $1.2 billion in participation fees.

H. Metrics

The Panel continues to monitor a number of metrics that the Panel and others, including Treasury, the Government Accountability Office (GAO), Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the Financial Stability Oversight Board, consider useful in assessing the effectiveness of the Administration's efforts to restore financial stability and accomplish the goals of the EESA. This section discusses changes that have occurred since the release of the September report.

• Interest Rate Spreads. Key interest rate spreads, a measure of the cost of capital, have continued to decline. Measures such as the LIBOR–OIS spread have largely returned to pre-crisis levels. Other important metrics such as the conventional mortgage rate spreads' 37 percent decrease since October 2008 also represents a positive indicator for the housing market and refinancing.[463]

FIGURE 31: INTEREST RATE SPREADS

Indicator	Current Spread [464] (as of 10/1/09)	Percent Change Since Last Report (9/1//09)
3 Month LIBOR–OIS Spread [465]	0.13	−23.5
1 Month LIBOR–OIS Spread [466]	0.1	11.1
TED Spread [467] (in basis points)	19.9	−3.7
Conventional Mortgage Rate Spread [468]	1.51	−9.04
Corporate AAA Bond Spread [469]	1.71	−2.48
Corporate BAA Bond Spread [470]	2.84	−7.79

[463] White House Press Release, *Executive Office of the President's Council of Economic Advisors CEA Notes on Refinancing Activity and Mortgage Rates* (Apr. 9, 2009) (online at www.whitehouse.gov/assets/documents/CEAHousingBackground.pdf) ("For the week ended April 2, the conforming mortgage rate (the rate for mortgages that meet the GSEs' standards) was 4.78%, the lowest weekly rate since 1971 (when the data series begins), and likely the lowest widely-available mortgage rate since the 1950s.").

FIGURE 31: INTEREST RATE SPREADS—Continued

Indicator	Current Spread [464] (as of 10/1/09)	Percent Change Since Last Report (9/1//09)
Overnight AA Asset-backed Commercial Paper Interest Rate Spread [471]	0.26	8.33
Overnight A2/P2 Nonfinancial Commercial Paper Interest Rate Spread [472]	.14	−12.5

[464] Percentage points, unless otherwise indicated.
[465] Bloomberg, *3 Mo LIBOR–OIS Spread* (online at www.bloomberg.com/apps/quote?ticker=.LOIS3:IND) (accessed Oct. 1, 2009).
[466] Bloomberg, *1 Mo LIBOR–OIS Spread* (online at www.bloomberg.com/apps/quote?ticker=.LOIS1:IND) (accessed Oct. 1, 2009).
[467] Bloomberg, *TED Spread* (online at www.bloomberg.com/apps/quote?ticker=.TEDSP:IND) (accessed Oct. 1, 2009).
[468] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Conventional Mortgages, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Thursday__/H15__MORTG__NA.txt) (accessed Oct. 1, 2009); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: U.S. Government Securities/Treasury Constant Maturities/Nominal 10-Year, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__/H15__TCMNOM__Y10.txt) (accessed Oct. 1, 2009) (hereinafter "Fed H.15 10-Year Treasuries").
[469] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned AAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__/H15__AAA__NA.txt) (accessed Oct. 1, 2009); Fed H.15 10-Year Treasuries, *supra* note 468.
[470] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned BAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__/H15__BAA__NA.txt) (accessed Oct. 1, 2009); Fed H.15 10-Year Treasuries, *supra* note 468.
[471] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Asset-Backed Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed July 9, 2009); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Oct. 1, 2009) (hereinafter "Fed CP AA Nonfinancial Rate").
[472] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: A2/P2 Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Oct. 1, 2009); Fed CP AA Nonfinancial Rate, *supra* note 471.

• **Commercial Paper Outstanding.** Commercial paper outstanding, a rough measure of short-term business debt, is an indicator of the availability of credit for enterprises. Two of the three measured commercial paper values increased since the Panel's September report, and one decreased. Asset-backed, financial and nonfinancial commercial paper have all decreased with nonfinancial commercial paper outstanding declining by over 46 percent, and asset-backed commercial paper outstanding declining over 27 percent since October 2008.

FIGURE 32: COMMERCIAL PAPER OUTSTANDING

Indicator	Current Level (as of 9/30/09) (Dollars in billions)	Percent Change Since Last Report (8/26/09)
Asset-Backed Commercial Paper Outstanding (seasonally adjusted) [473]	$522.3	14.09
Financial Commercial Paper Outstanding (seasonally adjusted) [474]	602.5	3.93
Nonfinancial Commercial Paper Outstanding (seasonally adjusted) [475]	106.2	−9

[473] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Asset-Backed Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Oct. 1, 2009).
[474] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Financial Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Oct. 1, 2009).
[475] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Nonfinancial Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Oct. 1, 2009).

Lending by the Largest TARP-recipient Banks. Treasury's Monthly Lending and Intermediation Snapshot tracks loan originations and average loan balances for the 22 largest recipients of CPP funds across a variety of categories, ranging from mortgage loans to commercial and industrial loans to credit card lines. Commercial lending, including new commercial real estate loans, continues to decline dramatically.

FIGURE 33: LENDING BY THE LARGEST TARP-RECIPIENT BANKS [476]

Indicator	Most Recent Data (July 2009) (Dollars in millions)	Percent Change Since June 2009	Percent Change Since October 2008
Total Loan Originations	$204,847	−9.7	−6.11
C&I New Commitments	32,169	−21.5	−45.4
CRE New Commitments	3,444	−6.96	−67.3

[476] U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot: Summary Analysis for July 2009* (Oct. 2, 2009) (online at www.financialstability.gov/docs/surveys/July%202009%20Tables.pdf). While the Treasury report is based upon the 22 largest CPP recipient banks, these data exclude two institutions—PNC and Wells Fargo—because they have made significant acquisitions since October 2008.

• **Loans and Leases Outstanding of Domestically-Chartered Banks.** Weekly data from the Federal Reserve Board track fluctuations among different categories of bank assets and liabilities. Loans and leases outstanding for large and small domestic banks both fell last month.[477] Total loans and leases outstanding at large banks have dropped by nearly 9 percent since last October.[478] Also, commercial and industrial loans and leases outstanding at large banks have continued to decline, having decreased over 15 percent since the enactment of EESA.

FIGURE 34: LOANS AND LEASES OUTSTANDING

Indicator (dollars in billions)	Current Level (as of 9/23/09)	Percent Change Since Last Report (8/26/09)	Percent Change Since EESA Signed into Law (10/3/08)
Large Domestic Banks—Total Loans and Leases	$3,692	−2.34	−8.92
Small Domestic Banks—Total Loans and Leases	$2,474	−0.87	−1.73
Large Domestic Banks—Commercial and Industrial Loans	$683	−4.11	−15.14
Small Domestic Banks—Revolving Consumer Credit	$89	−3.71	9.01

• **Housing Indicators.** Foreclosure filings fell slightly from July to August; however, foreclosures are still up by over 28 percent from October 2008 levels. Housing prices, as illustrated by the S&P/Case-Shiller Composite 20 Index, improved slightly in August, increasing by over 1.2 percent. The index remains down nearly nine percent since October 2008.

[477] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.8: Assets and Liabilities of Commercial Banks in the United States: Historical Data* (Instrument: Assets and Liabilities of Large Domestically Chartered Commercial Banks in the United States, seasonally adjusted, adjusted for mergers, billions of dollars) (online at www.federalreserve.gov/releases/h8/data.htm) (accessed Oct. 1, 2009).

[478] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.8: Assets and Liabilities of Commercial Banks in the United States: Historical Data* (Instrument: Assets and Liabilities of Small Domestically Chartered Commercial Banks in the United States, seasonally adjusted, adjusted for mergers, billions of dollars) (online at www.federalreserve.gov/releases/h8/data.htm) (accessed Oct. 1, 2009).

FIGURE 35: HOUSING INDICATORS

Indicator	Most Recent Monthly Data	Percent Change From Data Available at Time of Last Report (9/1/09)	Percent Change Since October 2008
Monthly Foreclosure Filings [479]	358,471	−.47	28.2
Housing Prices—S&P/Case-Shiller Composite 20 Index [480]	143.05	1.23	−8.9

[479] RealtyTrac, *Foreclosure Activity Press Releases* (online at www.realtytrac.com//ContentManagement/PressRelease.aspx) (accessed Oct. 1, 2009). The most recent data available is for August 2009.
[480] Standard & Poor's, *S&P/Case-Shiller Home Price Indices* (Instrument: seasonally Adjusted Composite 20 Index) (online at www2.standardandpoors.com/spf/pdf/index/SA__CSHomePrice__History__092955.xls) (accessed Oct. 1, 2009). The most recent data available is for July 2009.

• **Asset-Backed Security Issuance.** The ABS market slowed slightly in the third quarter with total issuance dropping by 1.25 percent. However, certain segments of the securitization market continued to improve in the third quarter. Auto ABS and home equity ABS have increased by over 700 and 180 percent respectively since October 2008. Through the first three quarters of 2009 there have been over $118 billion in ABS issued compared with just under $140 billion issued for the whole of 2008.[481]

FIGURE 36: ASSET-BACKED SECURITY ISSUANCE [482]

(Dollars in millions)

Indicator	Most recent quarterly data (3Q 2009)	Data available at time of last report (2Q 2009)	Percent change from data available at time of last report (9/1/09)
Auto ABS Issuance	$19,056	$12,026.8	58.5
Credit Cards ABS Issuance	$16,229.7	$19,158.5	−15.3
Equipment ABS Issuance	$578.8	$2,629.1	−78
Home Equity ABS Issuance	$486.6	$707.4	−31.2
Other ABS Issuance	$6,356.9	$6,444	−1.35
Student Loans ABS Issuance	$5,292.7	$7,643.8	−30.8
Total ABS Issuance	[483] $48,000.7	$48,609.6	−1.25

[482] Securities Industry and Financial Markets Association, US ABS Issuance (accessed Oct. 1, 2009) (online at www.sifma.org/uploadedFiles/Research/Statistics/SIFMA__USABSIssuance.pdf).
[483] $18.8 billion was requested under the Term Asset-Backed Securities Loan Facility during the third quarter of 2009. Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Announcements* (accessed August 5, 2008) (online at www.newyorkfed.org/markets/talf__announcements.html).

I. Financial Update

Each month since its April oversight report, the Panel has summarized the resources that the federal government has committed to economic stabilization. The following financial update provides: (1) an updated accounting of the TARP, including a tally of dividend income and repayments the program has received as of August 31, 2009; and (2) an update of the full federal resource commitment as of September 30, 2009.

1. TARP

a. Costs: Expenditures and Commitments [484]

Treasury is currently committed to spend $531.3 billion of TARP funds through an array of programs used to purchase preferred shares in financial institutions, offer loans to small businesses and

[481] Securities Industry and Financial Markets Association, US ABS Issuance (accessed Oct. 1, 2009) (online at www.sifma.org/uploaded Files/Research/Statistics/SIFMA__USABSIssuance.pdf).
[484] Treasury will release its next tranche report when transactions under the TARP reach $450 billion.

automotive companies, and leverage Federal Reserve loans for facilities designed to restart secondary securitization markets.[485] Of this total, $375.5 billion is currently outstanding under the $698.7 billion limit for TARP expenditures set by EESA, leaving $323.2 billion available for fulfillment of anticipated funding levels of existing programs and for funding new programs and initiatives. The $375.5 billion includes purchases of preferred and common shares, warrants and/or debt obligations under the CPP, TIP, SSFI Program, and AIFP; a $20 billion loan to TALF LLC, the special purpose vehicle (SPV) used to guarantee Federal Reserve TALF loans; and the $5 billion Citigroup asset guarantee, which was exchanged for a guarantee fee composed of additional preferred shares and warrants and has subsequently been exchanged for Trust Preferred shares.[486] Additionally, Treasury has allocated $23.4 billion to the Home Affordable Modification Program, out of a projected total program level of $50 billion.

b. Income: Dividends, Interest Payments, and CPP Repayments

A total of 39 institutions have completely repaid their CPP preferred shares, 24 of which have also repurchased warrants for common shares that Treasury received in conjunction with its preferred stock investments. There were over $375 million in repayments made under the CPP during September.[487] The seven banks that repaid were comparatively small with the largest repayment being for $125 million.[488] In addition, Treasury is entitled to dividend payments on preferred shares that it has purchased, usually five percent per annum for the first five years and nine percent per annum thereafter.[489] In total, Treasury has received approximately $86 billion in income from repayments, warrant repurchases, dividends, and interest payments deriving from TARP investments[490] and another $1.2 billion in participation fees from its Guarantee Program for Money Market Funds.[491]

c. Citigroup Exchange

Treasury has invested a total of $49 billion in Citigroup through three separate programs: the CPP, TIP, and AGP. On June 9, 2009, Treasury agreed to terms to exchange its CPP preferred stock holdings for 7.7 billion shares of common stock priced at $3.25/share

[485] EESA, as amended by the Helping Families Save Their Homes Act of 2009, limits Treasury to $698.7 billion in purchasing authority outstanding at any one time as calculated by the sum of the purchases prices of all troubled assets held by Treasury. Pub. L. No. 110–343, § 115(a)–(b), supra note 2; Helping Families Save Their Homes Act of 2009, Pub. L. No. 111–22, § 402(f) (reducing by $1.26 billion the authority for the TARP originally set under EESA at $700 billion).

[486] U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending September 30, 2009* (Oct. 4, 2009) (online at financialstability.gov/docs/transaction-reports/Transactions__Report__09-30-09.pdf) (hereinafter "September 30 TARP Transactions Report").

[487] *Id.*

[488] *Id.*

[489] See, for example, U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms* (online at www.financialstability.gov/docs/CPP/spa.pdf).

[490] U.S. Department of the Treasury, *Cumulative Dividends Report as of August 31, 2009* (Oct. 1, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/August2009__DividendsInterestReport.pdf); September 30 TARP Transactions Report, *supra* note 486.

[491] U.S. Department of the Treasury, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009) (online at www.financialstability.gov/latest/tg__09182009.html).

(for a total value of $25 billion) and also agreed to convert the form of its TIP and AGP holdings. On July 23, 2009, Treasury, along with both public and private Citigroup debt holders, participated in a $58 billion exchange. The company received shareholder approval for the exchange on September 3, 2009.[492] As of September 30, 2009, Treasury's common stock investment in Citigroup had a market value of $37.23 billion.[493]

[492] Citigroup, *Citi Announces Shareholder Approval of Increase in Authorized Common Shares, Paving Way to Complete Share Exchange* (Sept. 3, 2009) (online at www.citibank.com/citi/press/2009/090903a.htm).

[493] The Panel continues to account for Treasury's original $25 billion CPP investment in Citigroup under the CPP until formal approval of the exchange by Citigroup's shareholders and until Treasury specifies under which TARP program the common equity investment will be classified.

d. TARP Accounting

FIGURE 37: TARP ACCOUNTING (AS OF SEPTEMBER 30, 2009)

TARP Initiative (in billions)	Anticipated funding	Purchase price	Repayments	Net current investments	Net available
Total	$531.3	$455.5	$72.8	$380.2	[494] $318.5
CPP	$218	$204.6	$70.7	$134.2	[495] $13.7
TIP	$40	$40	$0	$40	$0
SSFI Program	$69.8	$69.8	$0	$69.8	$0
AIFP	$80	$80	$2.1	[496] $75.4	[497] $0
AGP	$5	$5	$0	$5	$0
CAP	TBD	$0	N/A	$0	N/A
TALF	$20	$20	$0	$20	$0
PPIP	$30	$9.2	N/A	$9.2	$20.8
Supplier Support Program	[498] $3.5	$3.5	$0	$3.5	$0
Unlocking SBA Lending	$15	$0	N/A	$0	$15
HAMP	$50	[499] $23.4	$0	$23.4	$26.6
(Uncommitted)	$167.4	N/A	N/A	N/A	[500] $242.7

[494] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($167.4 billion) and the difference between the total anticipated funding and the net current investment ($155.8 billion).

[495] This figure excludes the repayment of $70.7 billion in CPP funds. Secretary Geithner has suggested that funds from CPP repurchases will be treated as uncommitted funds of the TARP overall upon return to the Treasury.

[496] This figure reflects the amount invested in the AIFP as of August 18, 2009. This number consists of the original assistance amount of $80 billion less de-obligations ($2.4 billion) and repayments ($2.14 billion); $2.4 billion in apportioned funding has been de-obligated by Treasury ($1.91 billion of the available $3.8 billion of DIP financing to Chrysler and a $500 million loan facility dedicated to Chrysler that was unused). September 30 TARP Transactions Report, *supra* note 486.

[497] Treasury has indicated that it will not provide additional assistance to GM and Chrysler through the AIFP. Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry* (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report.pdf. The Panel therefore considers the repaid and de-obligated AIFP funds to be uncommitted TARP funds.

[498] On July 8, 2009, Treasury lowered the total commitment amount for the program from $5 billion to $3.5 billion, this reduced GM's portion from $3.5 billion to $2.5 billion and Chrysler's portion from $1.5 billion to $1 billion. September 30 Transactions Report, *supra* note 486.

[499] This figure reflects the total of all the caps set on payments to each mortgage servicer. September 30 Transactions Report, *supra* note 486.

[500] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($167.4 billion), the repayments ($72.8 billion), and the de-obligated portion of the AIFP ($2.4 billion). Treasury provided de-obligation information on August 18, 2009, in response to specific inquiries relating to the Panel's oversight of the AIFP. Specifically, this information denoted allocated funds that had since been de-obligated.

FIGURE 38: TARP REPAYMENTS AND INCOME

TARP initiatives (in billions)	Repayments (as of 9/30/09)	Dividends [501] (as of 8/31/09)	Interest [502] (as of 8/31/09)	Warrant repurchases [503] (as of 9/30/09)	Total
Total	$72.8	$9.74	$0.2	$2.9	$85.9
CPP	70.7	7.3	N/A	2.9	80.9
TIP	0	1.8	N/A	0	1.8
AIFP	2.1	0.47	.2	N/A	2.77
ASSP	N/A	N/A	.004	N/A	.004
AGP [504]	0	0.17	N/A	0	0.17
Bank of America Guarantee	—	—	—	—	[505] .276

[501] U.S. Department of the Treasury, *Cumulative Dividends Report as of August 31, 2009* (Oct. 1, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/August2009__DividendsInterestReport.pdf).

[502] U.S. Department of the Treasury, *Cumulative Dividends Report as of August 31, 2009* (Oct. 1, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/August2009__DividendsInterestReport.pdf).

[503] This number includes $1.6 million in proceeds from the repurchase of preferred shares by privately-held financial institutions. For privately-held financial institutions that elect to participate in the CPP, Treasury receives and immediately exercises warrants to purchase additional shares of preferred stock. September 30 Transactions Report, *supra* note 486.

[504] Citigroup is the lone participant in the AGP.

[505] On September 21, 2009 Bank of America announced the termination of its Asset Guarantee term sheet with the Treasury Department. Bank of America agreed to pay a total of $425 million to Treasury ($276 million), the Federal Reserve ($57 million), and the FDIC ($92 million) to terminate a provisional agreement to guarantee about $118 billion (later downsized to $83 billion) of Bank of America assets. Bank of America, *Termination Agreement* (Sep. 21, 2009) (online at online.wsj.com/public/resources/documents/bofa092109.pdf). Because Treasury's share of the termination fee derives from the never formally consummated provisional agreement and the components of the termination fee do not match this figure's repayment and income categories, we do not apportion the components here. Pursuant to the termination agreement, the government made retrospective valuations for Treasury's portion of the fee covering the four months when the provisional agreement was in place of: (1) "foregone dividends" ($52 million) on the preferred stock that would have been paid by Bank of America to Treasury had the federal government actually made the preferred stock investment contemplated by the provisional agreement; (2) a "pro-rated premium," ($119 million) representing the economic value to Bank of America of Treasury's never consummated preferred stock investment; and (3) a "warrants valuations," ($105 million) representing the economic value of the warrants purchase contemplated by the provisional agreement. Id. The FDIC's portion of the termination fee was determined by the same retrospective valuation methodology, but was proportionally smaller than Treasury's portion given the FDIC's more limited investment under the provisional agreement. Id. (calculating FDIC to receive $17 million for foregone dividends, $40 million for pro-rated premium for preferred stock, and $35 million for warrants investment). The Federal Reserve's $57 million portion of the termination fee is entirely composed on a pro-rated portion of the commitment fee contemplated by the provisional agreement ($34 million) plus expenses ($23 million). *Id.*

Rate of Return

As of September 30, 2009, the average internal rate of return for all financial institutions that participated in the CPP and fully repaid the U.S. government (including preferred shares, dividends, and warrants) is 17.2 percent. The internal rate of return is the annualized effective compounded return rate that can be earned on invested capital. In the case of the CAP program under TARP the return on investment includes dividends and warrants.

2. Other Financial Stability Efforts

Federal Reserve, FDIC, and Other Programs

In addition to the direct expenditures Treasury has undertaken through TARP, the federal government has engaged in a much broader program directed at stabilizing the U.S. financial system. Many of these initiatives explicitly augment funds allocated by Treasury under specific TARP initiatives, such as FDIC and Federal Reserve asset guarantees for Citigroup, or operate in tandem with Treasury programs, such as the interaction between PPIP and TALF. Other programs, like the Federal Reserve's extension of credit through its section 13(3) facilities and SPVs and the FDIC's Temporary Liquidity Guarantee Program, operate independent of TARP. As shown in the following table, the Federal Reserve has begun publishing its interest earnings on its financial stability initiatives.

FIGURE 39: FEDERAL RESERVE CREDIT EXPANSION PROGRAMS (AS OF SEPTEMBER 2009) [506]

(Dollars in millions)

Federal Reserve Credit Expansion Programs	Interest Earned Jan. 1–July 30, 2009
Federal agency debt securities	$614
Mortgage-backed securities	4,968
Term auction credit	570
Primary credit	[507] 134
Primary dealer and other broker-dealer credit	37
Mutual Fund Liquidity Facility	70
Central bank liquidity swaps	1,880
Outstanding principal amount of loan extended to Maiden Lane LLC	102
Commercial Paper Funding Facility	546
Total	8,524

[506] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.4.1: Factors Affecting Reserve Balances* (Oct. 1, 2009) (accessed Oct. 1, 2009) (online at www.federalreserve.gov/releases/h41/20091001/ (hereinafter "October 1 Fed Balance Sheet").

[507] This figure includes interest earned on primary, secondary and seasonal credit facilities.

3. Total Financial Stability Resources (as of September 30, 2009)

Beginning in its April report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy through a myriad of new programs and initiatives as outlays, loans, or guarantees. Although the Panel calculates the total value of these resources at over $3.2 trillion, this would translate into the ultimate "cost" of the stabilization effort only if: (1) assets do not appreciate; (2) no dividends are received, no warrants are exercised, and no TARP funds are repaid; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written off.

With respect to the FDIC and Federal Reserve programs, the risk of loss varies significantly across the programs considered here, as do the mechanisms providing protection for the taxpayer against such risk. The FDIC, for example, assesses a premium of up to 100 basis points on Temporary Liquidity Guarantee Program (TLGP) debt guarantees. The premiums are pooled and reserved to offset losses incurred by the exercise of the guarantees and are calibrated to be sufficient to cover anticipated losses and thus remove any downside risk to the taxpayer. In contrast, the Federal Reserve's liquidity programs are generally available only to borrowers with good credit, and the loans are over-collateralized and with recourse to other assets of the borrower. If the assets securing a Federal Reserve loan realize a decline in value greater than the "haircut," the Federal Reserve is able to demand more collateral from the borrower. Similarly, should a borrower default on a recourse loan, the Federal Reserve can turn to the borrower's other assets to make the Federal Reserve whole. In this way, the risk to the taxpayer on recourse loans only materializes if the borrower enters bankruptcy. The only loans currently "underwater"—where the outstanding principal amount exceeds the current market value of the collateral—are two of the three non-recourse loans to the Maiden Lane SPVs (used to purchase Bear Stearns and AIG assets).

FIGURE 40: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF SEPTEMBER 30, 2009)

[Dollars in billions]

Program	Treasury (TARP)	Federal reserve	FDIC	Total
Total	$698.7	$1,658	$846.7	[iii]$3,203.4
Outlays [i]	387.3	0	47.7	435
Loans	43.7	1,428.2	0	1,471.9
Guarantees [ii]	25	229.8	799	1,053.8
Uncommitted TARP Funds	242.7	0	0	242.7
AIG	[iv] 69.8	96.2	0	166
Outlays	69.8	0	0	69.8
Loans	0	[v] 96.2	0	96.2
Guarantees	0	0	0	0
Bank of America	45	0	0	45
Outlays	[vii] 45	0	0	45
Loans	0	0	0	0
Guarantees[vi]	0	0	0	0
Citigroup	50	229.8	10	289.8
Outlays	[viii] 45	0	0	45
Loans	0	0	0	0
Guarantees	[ix] 5	[x] 229.8	[xi] 10	244.8
Capital Purchase Program (Other)	97.3	0	0	97.3

FIGURE 40: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF SEPTEMBER 30, 2009)—Continued

[Dollars in billions]

Program	Treasury (TARP)	Federal reserve	FDIC	Total
Outlays	[xii] 97.3	0	0	97.3
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Assistance Program	TBD	0	0	[xv] TBD
TALF	20	180	0	200
Outlays	0	0	0	0
Loans	0	[xiv] 180	0	180
Guarantees	[xiii] 20	0	0	20
PPIP (Loans)[xvi]	0	0	0	0
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	0	0
PPIP (Securities)	[xvii] 30	0	0	30
Outlays	10	0	0	10
Loans	20	0	0	20
Guarantees	0	0	0	0
Home Affordable Modification Program	50	0	0	[xix] 50
Outlays	[xviii] 50	0	0	50
Loans	0	0	0	0
Guarantees	0	0	0	0
Automotive Industry Financing Program	75.4	0	0	75.4
Outlays	[xx] 55.2	0	0	55.2
Loans	20.2	0	0	20.2
Guarantees	0	0	0	0
Auto Supplier Support Program	3.5	0	0	3.5
Outlays	0	0	0	0
Loans	[xxi] 3.5	0	0	3.5
Guarantees	0	0	0	0
Unlocking SBA Lending	15	0	0	15
Outlays	[xxii] 15	0	0	15
Loans	0	0	0	0
Guarantees	0	0	0	0
Temporary Liquidity Guarantee Program	0	0	789	789
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	[xxiii] 789	789
Deposit Insurance Fund	0	0	47.7	47.7
Outlays	0	0	[xxiv] 47.7	47.7
Loans	0	0	0	0
Guarantees	0	0	0	0
Other Federal Reserve Credit Expansion	0	1,152	G19	1,152
Outlays	0	0	0	0
Loans	0	[xxv] 1,152	0	1,152
Guarantees	0	0	0	0
Uncommitted TARP Funds	242.7	0	0	242.7

[i] The term ''outlays'' is used here to describe the use of Treasury funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (e.g., debentures, preferred stock, exercised warrants, etc.). The outlays figures are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements and GAO estimates. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. Outlays as used here represent investments and assets purchases and commitments to make investments and asset purchases and are not the same as budget outlays, which under section 123 of EESA are recorded on a ''credit reform'' basis.

[ii] While many of the guarantees may never be exercised or exercised only partially, the guarantee figures included here represent the federal government's greatest possible financial exposure.

[iii] This figure is roughly comparable to the $3.0 trillion current balance of financial system support reported by SIGTARP in its July report. SIGTARP, *Quarterly Report to Congress*, at 138 (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf). However, the Panel has sought to capture additional anticipated exposure and thus employs a different methodology than SIGTARP.

[iv] This number includes investments under the SSFI Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment committed on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees). September 30 TARP Transactions Report, *supra* note 486.

[v] This number represents the full $60 billion that is available to AIG through its revolving credit facility with the Federal Reserve ($39.1 billion had been drawn down as of September 2, 2009) and the outstanding principle of the loans extended to the Maiden Lane II and III SPVs to buy AIG assets (as of September 24, 2009, $16.6 billion and $19.6 billion respectively). October 1 Fed Balance Sheet, *supra* note 441. Income from the purchased assets is used to pay down the loans to the SPVs, reducing the taxpayers' exposure to losses over time. Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, at 16 (Aug. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200909.pdf) (hereinafter ''Fed September 2009 Credit and Liquidity Report'').

[vi] Beginning in our July report, the Panel excluded from its accounting the $118 billion asset guarantee agreement among Bank of America, the Federal Reserve, Treasury, and the FDIC based on testimony from Federal Reserve Chairman that the agreement was never signed and was never signed or consummated and the absence of the guarantee from Treasury's TARP accounting. House Committee on Oversight and Government Reform, Testimony of Federal Reserve Chairman Ben S. Bernanke, *Acquisition of Merrill Lynch by Bank of America*, at 3 (June 25, 2009) (online at oversight.house.gov/documents/20090624185603.pdf) (''The ring-fence arrangement has not been consummated, and Bank of America now believes that, in light of the general improvement in the markets, this protection is no longer needed.''); Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchase of Stock Warrants*, at 85 (July 7, 2009) (online at cop.senate.gov/documents/cop–071009–report.pdf). On September 21, 2009 Bank of America announced that it had reached an agreement with Treasury to resolve the matter of the implied guarantee by paying $425 million to terminate the term sheet. Bank of America, *Bank of America Terminates Asset Guarantee Term Sheet* (Sept. 21, 2009) (online at newsroom.bankofamerica.com/index.php?s=43&item=8536). For further discussion of the Panel's approach to classifying this agreement, see Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry*, at 209 (Sept. 9, 2009) (online at cop.senate.gov/documents/cop–090909–report.pdf).

[vii] *September 30 TARP Transactions Report, supra* note 486. This figure includes: (1) a $15 billion investment made by Treasury on October 28, 2008 under the CPP; (2) a $10 billion investment made by Treasury on January 9, 2009 also under the CPP; and (3) a $20 billion investment made by Treasury under the TIP on January 16, 2009.

[viii] September 30 TARP Transactions Report, *supra* note 486. This figure includes: (1) a $25 billion investment made by Treasury under the CPP on October 28, 2008; and (2) a $20 billion investment made by Treasury under TIP on December 31, 2008.

[ix] U.S. Department of the Treasury, *Summary of Terms: Eligible Asset Guarantee* (Nov. 23, 2008) (online at www.treasury.gov/press/releases/reports/cititermsheet—112308.pdf) (hereinafter ''Citigroup Asset Guarantee'') (granting a 90 percent federal guarantee on all losses over $29 billion after existing reserves, of a $306 billion pool of Citigroup assets, with the first $5 billion of the cost of the guarantee borne by Treasury, the next $10 billion by FDIC, and the remainder by the Federal Reserve). See also U.S. Department of the Treasury, *U.S. Government Finalizes Terms of Citi Guarantee Announced in November* (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1358.htm) (reducing the size of the asset pool from $306 billion to $301 billion).

[x] Citigroup Asset Guarantee, *supra* note ix..

[xi] Citigroup Asset Guarantee, *supra* note ix.

[xii] This figure represents the $218 billion Treasury has anticipated spending under the CPP, minus the $50 billion investment in Citigroup ($25 billion) and Bank of America ($25 billion) identified above, and the $70.7 billion in repayments that are reflected as uncommitted TARP funds. This figure does not account for future repayments of CPP investments, nor does it account for dividend payments from CPP investments.

[xiii] This figure represents a $20 billion allocation to the TALF SPV on March 3, 2009. *September 30 TARP Transactions Report, supra* note 486. Consistent with the analysis in our August report, only $43 billion dollars has been lent through TALF as of September 23 2009, the Panel continues to predict that TALF subscriptions are unlikely to surpass the $200 billion currently available by year's end. Congressional Oversight *Panel, August Oversight Report: The Continued Risk of Troubled Assets*, at 10–22 (August 11, 2009) (discussion of what constitutes a ''troubled asset'') (online at cop.senate.gov/documents/cop–081109–report.pdf).

[xiv] This number is derived from the unofficial 1:10 ratio of the value of Treasury loan guarantees to the value of Federal Reserve loans under the TALF. U.S. Department of the Treasury, *Fact Sheet: Financial Stability Plan* (Feb.10, 2009) (online at www.financialstability.gov/docs/fact-sheet.pdf) (describing the initial $20 billion Treasury contribution tied to $200 billion in Federal Reserve loans and announcing potential expansion to a $100 billion Treasury contribution tied to $1 trillion in Federal Reserve loans). Because Treasury is responsible for reimbursing the Federal Reserve Board for $20 billion of losses on its $200 billion in loans, the Federal Reserve Board's maximum potential exposure under the TALF is $180 billion.

[xv] The CAP was announced on February 25, 2009 and as of yet has not been utilized. The Panel will continue to classify the CAP as dormant until a transaction is completed and reported as part of the program.

[xvi] It now appears unlikely that resources will be expended under the PPIP Legacy Loans Program in its original design as a joint Treasury-FDIC program to purchase troubled assets from solvent banks. See also Federal Deposit Insurance Corporation, *FDIC Statement on the Status of the Legacy Loans Program* (June 3, 2009) (online at www.fdic.gov/news/news/press/2009/pr09084.html) and Federal Deposit Insurance Corporation, *Legacy Loans Program—Test of Funding Mechanism* (July 31, 2009) (online at www.fdic.gov/news/news/press/2009/pr09131.html). The sales described in these statements do not involve any Treasury participation, and FDIC activity is accounted for here as a component of the FDIC's Deposit Insurance Fund outlays.

[xvii] U.S. Department of the Treasury, *Joint Statement By Secretary of the Treasury Timothy F. Geithner, Chairman of the Board Of Governors Of The Federal Reserve System Ben S. Bernanke, and Chairman of the Federal Deposit Insurance Corporation Sheila Bair: Legacy Asset Program* (July 8, 2009) (online at www.financialstability.gov/latest/tg_07082009.html) (''Treasury will invest up to $30 billion of equity and debt in PPIFs established with private sector fund managers and private investors for the purpose of purchasing legacy securities.''); U.S. Department of the Treasury, *Fact Sheet: Public-Private Investment Program*, at 4–5 (Mar. 23, 2009) (online at www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf) (hereinafter ''Treasury PPIP Fact Sheet'') (outlining that, for each $1 of private investment into a fund created under the Legacy Securities Program, Treasury will provide a matching $1 in equity to the investment fund; a $1 loan to the fund; and, at Treasury's discretion, an additional loan up to $1). In the absence of Treasury guidance, the Panel had previously adopted a 1:1.5 ratio between Treasury equity co-investments and loans at a 1:2 ratio under the program, reflecting an assumption that Treasury would frequently but not always exercise its discretion to provide additional financing. However, Treasury's announcement of the initial round of completed PPIP legacy securities agreements totaling $1.13 billion suggests that Treasury may routinely exercise its discretion to provide $2 of financing for every $1 of equity. See U.S. Department of the Treasury, *Treasury Department Announces Initial Closings of Legacy Securities Public-Private Investment Funds* (Sept. 30, 2009) (online at www.ustreas.gov/press/releases/tg304.htm) (indicating that investors would be eligible for $2.26 billion of financing on their investments and that total Treasury financing would be $20 billion on $10 billion on investors' equity investments).

[xviii] U.S. Government Accountability Office, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, at 2 (June 17, 2009) (GAO09/658) (online at www.gao.gov/new.items/d09658.pdf) (hereinafter ''GAO June 29 Status Report''). Of the $50 billion in announced TARP funding for this program, $23.4 billion has been allocated as of August 28, 2009, and no funds have yet been disbursed. September 30 TARP Transactions Report, *supra* note 486.

[xix] Fannie Mae and Freddie Mac, government-sponsored entities (GSEs) that were placed in conservatorship of the Federal Housing Finance Housing Agency on September 7, 2009, will also contribute up to $25 billion to the Making Home Affordable Program, of which the HAMP is a key component. MHAP Update, supra note 69. U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).

[xx] September 30 TARP Transactions Report, *supra* note 486. A substantial portion of the total $80 billion in loans extended under the AIFP have since been converted to common equity and preferred shares in restructured companies. $20.2 billion has been retained as first lien debt (with $7.7 billion committed to GM and $12.5 billion to Chrysler). This figure represents Treasury's current obligation under the AIFP. There have been $2.1 billion in repayments and $2.4 billion in de-obligated funds under the AIFP. Treasury De-obligation Document. See also GAO June 29 Status Report, *supra* note xviii at 43.

[xxi] September 30 TARP Transactions Report, *supra* note 486.

[xxii] Treasury PPIP Fact Sheet, *supra* note xvii.

[xxiii] This figure represents the current maximum aggregate debt guarantees that could be made under the program, which, in turn, is a function of the number and size of individual financial institutions participating. $ 307 billion of debt subject to the guarantee has been issued to date, which represents about 40 percent of the current cap. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program: Debt Issuance Under Guarantee Program* (Aug. 31, 2009) (online at www.fdic.gov/regulations/resources/TLGP/total__issuance8–09.html) (updated Sep. 24, 2009). The FDIC has collected $9.35 billion in fees and surcharges from this program since its inception in the fourth quarter of 2008. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Aug. 31, 2009) (online at www.fdic.gov/regulations/resources/TLGP/fees.html) (updated Sept. 24, 2009).

[xxiv] This figure represents the FDIC's provision for losses to its deposit insurance fund attributable to bank failures in the third and fourth quarters of 2008 and the first and second quarters of 2009. Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Fourth Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__4qtr__08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__3rdqtr__08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (First Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__1stqtr__09/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Second Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__2ndqtr__09/income.html). This figure includes the FDIC's estimates of its future losses under loss share agreements that it has entered into with banks acquiring assets of insolvent banks during these three quarters. Under a loss sharing agreement, as a condition of an acquiring bank's agreement to purchase the assets of an insolvent bank, the FDIC typically agrees to cover 80 percent of an acquiring bank's future losses on an initial portion of these assets and 95 percent of losses of another portion of assets. See, for example Federal Deposit Insurance Corporation, *Purchase and Assumption Agreement Among FDIC, Receiver of Guaranty Bank, Austin, Texas, FDIC and Compass Bank* at 65–66 (Aug. 21, 2009) (online at www.fdic.gov/bank/individual/failed/guaranty-tx__p__and__a__w__addendum.pdf).In information provided to Panel staff, the FDIC disclosed that there were approximately $82 billion in assets covered under loss-share agreements as of September 4, 2009. Furthermore, the FDIC estimates the total cost of a payout under these agreements to be $36.2 billion. Since there is a published loss estimate for these agreements, the Panel continues to reflect them as outlays rather than as guarantees. By comparison, the TLGP does not have published loss-estimates and therefore remains classified as guarantee program.

[xxv] This figure is derived from adding the total credit the Federal Reserve Board has extended as of August 27, 2009 through the Term Auction Facility (Term Auction Credit), Discount Window (Primary Credit), Primary Dealer Credit Facility (Primary Dealer and Other Broker-Dealer Credit), Central Bank Liquidity Swaps, loans outstanding to Bear Stearns (Maiden Lane I LLC), GSE Debt Securities (Federal Agency Debt Securities), Mortgage Backed Securities Issued by GSEs, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and Commercial Paper Funding Facility LLC. Fed Balance Sheet October 1, supra note 506. The level of Federal Reserve lending under these facilities will fluctuate in response to market conditions. Fed Report on Credit and Liquidity, *supra* note v.

SECTION FIVE: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of the Emergency Economic Stabilization Act (EESA) and formed on November 26, 2008. Since then, the Panel has produced ten oversight reports, as well as a special report on regulatory reform, issued on January 29, 2009, and a special report on farm credit, issued on July 21, 2009. Since the release of the Panel's September oversight report on the use of TARP funds in support and reorganization of the domestic automotive industry, the following developments pertaining to the Panel's oversight of the Troubled Asset Relief Program (TARP) took place:

- The Panel held a hearing in Washington, D.C. with Secretary Geithner on September 10. This was Secretary Geithner's second appearance before the Panel. Secretary Geithner answered questions regarding the current state of the economy and the progress TARP has made during the last year in stabilizing the financial markets. During the hearing, Secretary Geithner promised Panel Members that he would provide additional information regarding several TARP programs and would continue to appear before the Panel in an open public hearing format at regular intervals.
- The Panel held a field hearing in Philadelphia, Pennsylvania on September 24, to examine foreclosure mitigation efforts under TARP. The Panel heard testimony from representatives of Treasury, the GSEs, community housing organizations, loan servicers, an economist, and Judge Annette M. Rizzo of the Philadelphia Court of Common Pleas. The testimony revealed the successes and challenges of various foreclosure mitigation programs. The hearing played an important role in the Panel's evaluation of TARP foreclosure mitigation efforts, as reflected in the October oversight report.
- On September 24, 2009, Treasury Assistant for Financial Stability Secretary Herbert Allison testified before the Senate Banking Committee regarding TARP's impact during its first year. Assistant Secretary Allison discussed briefly the status and impact of each of the major TARP initiatives and indicated Treasury's intention to wind-down each program on a case-by-case basis. During questions from the committee, Assistant Secretary Allison declined to indicate whether Treasury would extend TARP beyond December 31, 2009.
- Chair Elizabeth Warren, on behalf of the Panel, appeared before the Senate Banking Committee on September 24, 2009. Chair Warren testified regarding the positive effects and shortcomings of TARP during its first year of existence.

Upcoming Reports and Hearings

The Panel will release its next oversight report in November. The report will provide an updated review of TARP activities and continue to assess the program's overall effectiveness. The report will also examine the Treasury guarantees of bank assets.

The Panel will hold a hearing with Assistant Secretary Allison on October 22, 2009. The Assistant Secretary last testified before the Panel on June 24, 2009.

SECTION SIX: ABOUT THE CONGRESSIONAL OVERSIGHT PANEL

In response to the escalating crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to "review the current state of financial markets and the regulatory system." The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers." The Panel issued this report in January 2009. Congress subsequently expanded the Panel's mandate by directing it to produce a special report on the availability of credit in the agricultural sector. The report was issued on July 21, 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL–CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19, 2008 of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel. Effective August 10, 2009, Senator Sununu resigned from the Panel and on August 20, Senator McConnell announced the appointment of Paul Atkins, former Commissioner of the U.S. Securities and Exchange Commission, to fill the vacant seat.

ACKNOWLEDGEMENTS

The Panel thanks Adam J. Levitin, Associate Professor of Law at the Georgetown University Law Center, for the significant contribution he made to this report. The Panel also expresses its appreciation to Alan M. White, Assistant Professor of Law, Valparaiso University School of Law, for his cost benefit analysis of the federal foreclosure mitigation initiative.

APPENDIX I: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER RE: THE STRESS TESTS, DATED SEPTEMBER 15, 2009

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

September 15, 2009

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
Room 3330
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

Thank you for taking the time to testify before the Congressional Oversight Panel last Thursday. It is always instructive to hear directly your views on the current state of the economy and the progress that has been made over the past year. The Panel is currently compiling a list of questions for the record, which we expect will be ready for your review shortly.

In the meantime, I hope that you can provide us with the information regarding the stress tests that you and I discussed both during and after your testimony. At that time, you said that you would be willing to provide us with the inputs and formulae for the stress tests. We would appreciate receiving that information as soon as possible. In addition to that information, we are also interested in receiving answers from you to the following questions, some of which were included in the request for information we sent to you on March 30, 2009.

You stated during your testimony that the indicative loss rates that were used to estimate losses in the more adverse scenario set higher than those seen by the United States during the Great Depression. Obviously we have not actually seen such high loss rates. What factors led you to believe that it was necessary to use such a conservative estimate?

As part of the stress tests, the bank holding companies being tested were required to provide loan loss estimates in twelve categories under each of the proposed scenarios, guided by indicative loss rates provided by the Federal Reserve. Now that results from the first two quarters of 2009 are available, how do the actual first and second quarter results compare to the estimated loss rates and the indicative rates? Are you able to provide us actual loss rates in each of the twelve categories for both quarters? To the extent that the actual results differ from the indicative rates, what factors contributed to the divergence?

During the hearing, you testified that the fact that unemployment figures are higher than were estimated in the more adverse scenario is immaterial to the value of the stress test results. Because the unemployment metrics were those advanced by the Treasury, can you explain why this is true? What factors were considered in reaching the metrics that underlay the indicative loss rates and how was each factor weighted? Why were these factors selected, and how was it determined how each should be weighted?

Again, thank you for your testimony last week. I look forward to receiving the inputs and formulae used in the stress tests, and your answers to the questions above.

Sincerely,

EWarren

Elizabeth Warren
Chair
Congressional Oversight Panel

Cc:
Mr. Paul Atkins
Rep. Jeb Hensarling
Mr. Richard H. Neiman
Mr. Damon A. Silvers

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