

March 2011

TROUBLED ASSET RELIEF PROGRAM

Treasury Continues to Face Implementation Challenges and Data Weaknesses in Its Making Home Affordable Program



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Why GAO Did This Study

Two years after the Department of the Treasury (Treasury) first made available up to \$50 billion for the Making Home Affordable (MHA) program, foreclosure rates remain at historically high levels. Treasury recently introduced several new programs intended to further help homeowners. This report examines (1) the status of three of these new programs, (2) characteristics of homeowners with first-lien modifications from the Home Affordable Modification Program (HAMP), and (3) the outcomes for borrowers who were denied or fell out of first-lien modifications. To address these questions, GAO analyzed data from Treasury and six large MHA servicers.

What GAO Recommends

GAO recommends that Treasury require servicers to advise borrowers to contact servicers about second-lien modifications and ensure that servicers demonstrate the capacity to successfully implement Treasury's new programs. GAO also recommends that Treasury consider methods to better capture outcomes for borrowers denied or canceled from HAMP first-lien modifications. Treasury acknowledged challenges faced by servicers in implementing the program, but felt that certain criticisms of MHA were unwarranted. However, we continue to believe that further action is needed to better ensure the effectiveness of these programs.

View [GAO-11-288](#) or key components. For more information, contact Mathew J. Scire` at (202) 512-8678 or sciremj@gao.gov.

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What GAO Found

The implementation of Treasury's programs to reduce or eliminate second-lien mortgages, encourage the use of short sales or deeds-in-lieu, and stimulate the forgiveness of principal has been slow and limited activity has been reported to date (see table). This slow pace is attributed in part to several implementation challenges. For example, servicers told GAO that the start of the second-lien modification program had been slow due to problems with the database Treasury required them to use to identify potentially eligible loans. Additionally, borrowers may not be aware of their potential eligibility for the program. While Treasury recently revised its guidelines to allow servicers to bypass the database for certain loans, servicers could do more to alert HAMP first-lien modification borrowers about the new second-lien program. Implementation of the foreclosure alternatives program has also been slow due to program restrictions, such as the requirement that borrowers be evaluated for a first-lien modification even if they have already identified a potential buyer for a short sale. Although Treasury has recently taken action to address some of these concerns, the potential effects of its changes remain unclear.

In addition, Treasury has not fully incorporated into its new programs key lessons from its first-lien modification program. For example, it has not obtained all required documentation to demonstrate that servicers have the capacity to successfully implement the newer programs. As a result, servicers' ability to effectively offer troubled homeowners second-lien modifications, foreclosure alternatives, and principal reductions is unclear. Finally, Treasury has not implemented GAO's June 2010 recommendation that it establish goals and effective performance measures for these programs. Without performance measures and goals, Treasury will not be able to effectively assess the outcomes of these programs.

Activity Under the Second-lien, Foreclosure Alternative, and Principal Reduction Programs as of December 31, 2010

Program	Date announced	Implementation date	Funding allocation	Reported activity as of December 31, 2010
Second-lien Modification	March 2009	March 2010	Nearly \$133 million	\$2.9 million in incentives paid
Home Affordable Foreclosure Alternatives	March 2009	April 5, 2010	\$4.1 billion	\$9.5 million in incentives paid
Principal Reduction Alternative	March 2010	October 1, 2010	\$2.0 billion	Activity not yet reported ^a

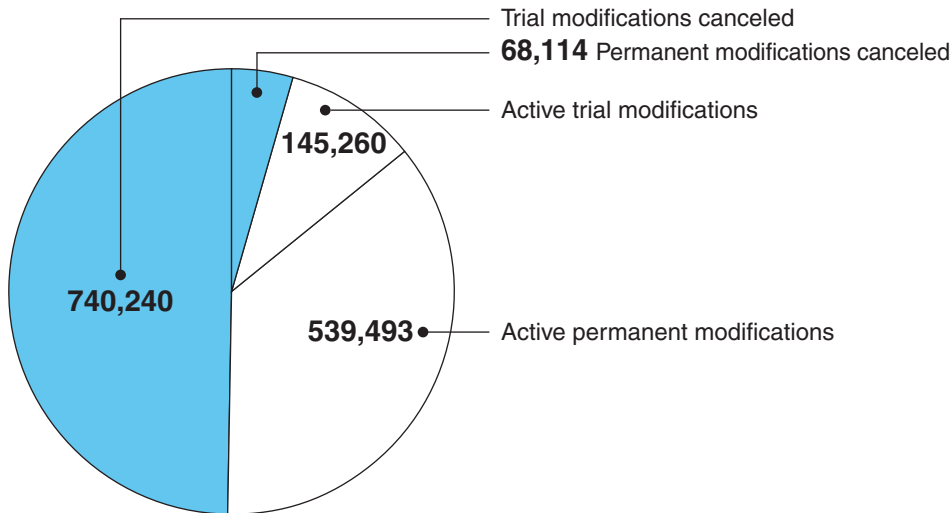
Source: Treasury.

^aPRA incentives are paid on an annual basis contingent upon successful performance of the modified mortgage during the preceding 12 months.

Treasury's data provide important insights into the characteristics of borrowers participating in the HAMP first-lien modification program, but data were sometimes missing or questionable. As shown in the figure, more homeowners have been denied or canceled from HAMP trial loan modifications than have received permanent modifications. To understand which borrowers HAMP has been able to help, GAO looked at Treasury's data on borrowers in HAMP trial and permanent modifications. These data showed that HAMP borrowers had reduced income and high debt, but the reliability and integrity of some of Treasury's information was questionable. For example, Treasury's data on borrowers' loan-to-value ratios at the time of modification ranged from 0 to 999, with 1 percent of TARP-funded active permanent modifications reporting ratios over 400 percent. In addition, race and ethnicity data were not available for a significant portion of borrowers. Treasury said that it was refining and strengthening data quality checks and that the data have improved and will continue to improve over time. Treasury's success in improving the quality and completeness of HAMP data will be critical to its ability to evaluate program results and achieve the goals of preserving homeownership and protecting home values.

While it appears that most borrowers who were denied or canceled from HAMP first-lien trial modifications have been able to avoid foreclosure to date, weaknesses in how Treasury requires servicers to report data make it difficult to understand what ultimately happens to these borrowers. First, Treasury's system for reporting outcomes requires servicers to place borrowers in only one category, even when borrowers are being evaluated for several possible outcomes, with proprietary modifications reported first. As a result, the proportion of borrowers reported receiving proprietary modifications is likely to be overstated relative to other possible outcomes, such as foreclosure starts. Further, Treasury does not require servicers to distinguish between completed and pending actions, so that some reported outcomes may not be clear. Without more accurate information on the outcomes of borrowers who are denied HAMP modifications, have them canceled, or redefault, Treasury's ability to determine whether further action is needed to assist struggling homeowners is diminished.

Number of Active and Canceled Trial and Permanent Modifications through January 2011



Source: Treasury.

Contents

Letter		1
	Background	4
	Implementation of Treasury’s Newer Housing Programs Has Been Slow and Capacity of Servicers to Carry Out These Programs Remains Unclear, Raising Uncertainty About the Potential Impact of These Programs	11
	Treasury Has Some Data on the Characteristics of Borrowers in HAMP’s First-Lien Program, but Data Were Sometimes Missing or Questionable	25
	Most Borrowers Denied or Canceled from Trial Modifications Appear to Have Avoided Foreclosure To Date, but Weaknesses in Treasury’s Data Collection Limit its Ability to Understand the Outcomes of These Borrowers	32
	Conclusions	47
	Recommendations for Executive Action	50
	Agency Comments and Our Evaluation	51
Appendix I	Scope and Methodology	56
Appendix II	Description of GAO’s Econometric Analysis of HAMP Trial Loans Modifications Cancellations	59
Appendix III	Comments from the Department of the Treasury	68
Appendix IV	GAO Contacts and Staff Acknowledgments	77
Tables		
	Table 1: Selected Outcomes of Borrowers who Had a Canceled HAMP Trial Modification by Servicer, through August 31, 2010	39
	Table 2: Terms of Selected Proprietary Modification Programs Compared to HAMP	44
	Table 3: Summary Statistics of Variables Used in Regression	60

Table 4: Probabilistic Estimates of HAMP Trial Loan Modification Cancellation Rates	62
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Figures

Figure 1: National Default and Foreclosure Trends from Calendar Years 1979-2010	5
Figure 2: GSE and Non-GSE HAMP Trial and Permanent Modifications Made and Canceled Each Month, through January 2011	10
Figure 3: Timeline of 2MP, HAFA, and PRA Guidance	21
Figure 4: Estimated Decrease/Increase in Likelihood of Cancellation of HAMP Trial Modification by Borrower and Loan Characteristics	28
Figure 5: Outcomes of Borrowers Denied a HAMP Trial Modification, through August 31, 2010 (Six large MHA servicers)	37
Figure 6: Outcomes of Borrowers who Had a Canceled HAMP Trial Modification, through August 31, 2010 (Six large MHA servicers)	38
Figure 7: Outcomes of Borrowers Who Redefaulted on a HAMP Permanent Modification, through August 31, 2010 (Six large MHA servicers)	40
Figure 8: Number of Proprietary and HAMP Modifications Started Each Month, January through December 2010	41
Figure 9: Estimated Change in Likelihood of Cancellation of HAMP Trial Loan Modification by Servicer, Delinquency Status Before Modification	65
Figure 10: Estimated Change in Likelihood of Cancellation of HAMP Trial Loan Modification by State	66

Abbreviations

2MP	Second-Lien Modification Program
DTI	debt-to-income ratio
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
GSE	government-sponsored enterprise
HAFA	Home Affordable Foreclosure Alternatives Program
HAMP	Home Affordable Modification Program
HPO	Homeownership Preservation Office
HUD	Department of Housing and Urban Development
IR/2	Investor Reporting/2
LTV	loan-to-value
LPS	Lender Processing Services
MHA	Making Home Affordable
MHA-C	Making Home Affordable-Compliance
MLTV	mark-to-market loan-to-value
NPV	net present value
OCC	Office of the Comptroller of the Currency
OFS	Office of Financial Stability
OTS	Office of Thrift Supervision
PRA	Principal Reduction Alternative
SIGTARP	Office of the Special Inspector General for TARP
SPA	Servicer Participation Agreement
TARP	Troubled Asset Relief Program

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United States Government Accountability Office
Washington, DC 20548

March 17, 2011

Congressional Committees

Since the Department of the Treasury (Treasury) first announced the framework for its Making Home Affordable (MHA) program over 2 years ago, the number of homeowners facing potential foreclosure has remained at historically high levels. The Emergency Economic Stabilization Act of 2008, which authorized Treasury to establish the \$700 billion Troubled Asset Relief Program (TARP), was intended to, among other things, preserve homeownership and protect home values.¹ In February 2009, Treasury announced that up to \$50 billion in TARP funds was allocated to help struggling homeowners avoid potential foreclosure. The key component under MHA, the Home Affordable Modification Program (HAMP), offered modifications on first-lien mortgages to reduce borrowers' monthly mortgage payments to affordable levels, avoid foreclosure, and keep their homes. Since HAMP's inception, concerns have been raised that the program was not reaching the expected number of homeowners. In two prior reports, we looked at the implementation of the HAMP first-lien modification program and noted that Treasury faced challenges in implementing the program and made several recommendations intended to address these challenges.² In addition, the

¹Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632 (2009), amended the act to reduce the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.741 billion. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (1) reduced Treasury's authority to purchase or insure troubled assets to a maximum of \$475 billion and (2) prohibited Treasury, under the Emergency Economic Stabilization Act of 2008, from incurring any additional obligations for a program or initiative, unless the program or initiative had already been introduced prior to June 25, 2010.

²GAO is required to report at least every 60 days on findings resulting from, among other things, oversight of TARP's performance in meeting the purposes of the act, the financial condition and internal controls of TARP, the characteristics of both asset purchases and the disposition of assets acquired, the efficiency of TARP's operations in using appropriated funds, and TARP's compliance with applicable laws and regulations 12 U.S.C. § 5226(a). Under this statutory mandate, we have reported on Treasury's use of TARP funds to preserve homeownership and protect home values. See GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, [GAO-09-837](#) (Washington, D.C.: July 23, 2009) and GAO, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, [GAO-10-634](#) (Washington, D.C.: June 24, 2010).

Special Inspector General for TARP (SIGTARP) and the Congressional Oversight Panel have issued several reports containing various recommendations to Treasury intended to improve the transparency, accountability, and effectiveness of MHA.³

Questions continue to be raised about the extent to which the first-lien program has effectively reached struggling homeowners and reduced avoidable foreclosures. For example, more homeowners have been denied or canceled from HAMP first-lien trial loan modifications than have received permanent modifications to date, raising questions about which homeowners HAMP has been able to help and how best to meet the needs of homeowners struggling to avoid foreclosure. Treasury has begun implementing several other TARP-funded programs for struggling homeowners under the MHA program, including the Second-Lien Modification Program (2MP), the Principal Reduction Alternatives (PRA) program for borrowers who owe more on their mortgages than the value of their homes, and the Home Affordable Foreclosure Alternatives (HAFA) program for those who are not successful in HAMP modifications.⁴ All are funded by the \$50 billion originally allocated for MHA, which has since been reduced to \$45.6 billion for all TARP-funded housing programs, and further reduced to \$29.9 billion for MHA programs (with the remainder of the balance being allocated to the HFA Hardest-Hit Fund and the FHA Short Refinance option). Because of concerns about the effectiveness of these newer TARP-funded programs, this report examines the extent to which these programs have been successful at reaching struggling homeowners. To understand the extent to which Treasury has been able to assess who has been reached by HAMP and what additional actions may be needed to help struggling homeowners, we also examined the characteristics of homeowners who have been assisted by the HAMP first-lien modification program and the outcomes of borrowers who did not complete HAMP trial or permanent modifications. We also have ongoing

³For example, see Congressional Oversight Panel, *April Oversight Report: Evaluating Progress on TARP Foreclosure Mitigation Programs* (Washington, D.C., Apr. 14, 2010) and Office of the Special Inspector General for the Troubled Asset Relief Program, *Factors Affecting Implementation of the Home Affordable Modification Program*, SIGTARP-10-005 (Washington, D.C., Mar. 25, 2010).

⁴Treasury has also put in place the Federal Housing Administration (FHA)-HAMP, Rural Development-HAMP, the FHA Short Refinance Option, the Housing Finance Agency Innovation Fund for the Hardest-Hit Markets, and the Home Affordable Unemployment Program. Information on the progress made by these TARP-funded programs in stemming avoidable foreclosures will be discussed in a future report.

work looking at the broader federal response to the foreclosure crisis, which encompasses both TARP and non-TARP funded efforts intended to mitigate the impact of foreclosures on homeowners.

More specifically, this report examines (1) the status of Treasury's second-lien modification, principal reduction, and foreclosure alternatives programs; (2) the characteristics of homeowners who HAMP has been able to help under the first-lien modification program; and (3) the outcomes for borrowers who were denied or fell out of HAMP trial or permanent first-lien modifications.

To address these questions, we obtained information from and spoke with six large MHA servicers who collectively represented about 74 percent of the TARP funds allocated to servicers participating in the program. In addition, we reviewed MHA program documentation that Treasury issued, including supplemental directives for the second-lien modification, principal reduction, and foreclosure alternatives programs. In addition, we spoke with members of a trade association who represented both residential mortgage loan investors and servicers, and one who represents private mortgage loan insurers. We also analyzed loan level data from Treasury's HAMP database, which included data reported by servicers on borrowers evaluated for HAMP participation through September 30, 2010, to analyze the characteristics of borrowers who received HAMP, were canceled from HAMP trial modifications, or redefaulted from permanent HAMP modifications. To understand the outcomes of borrowers who were denied or canceled from HAMP, we requested and obtained data from each of the six servicers noted above. Finally, we conducted a Web-based survey of housing counselors through NeighborWorks, which funds a national network of housing counselors to obtain their perspectives of the HAMP program.⁵ We coordinated our work with other oversight entities that TARP created—the Congressional Oversight Panel, the Office of the Special Inspector General for TARP, and the Financial Oversight Stability Board.

We conducted this performance audit from July 2010 through March 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain

⁵This report does not contain all the results from our survey of housing counselors. The survey and a more complete tabulation of the results will be discussed in more detail in an upcoming report.

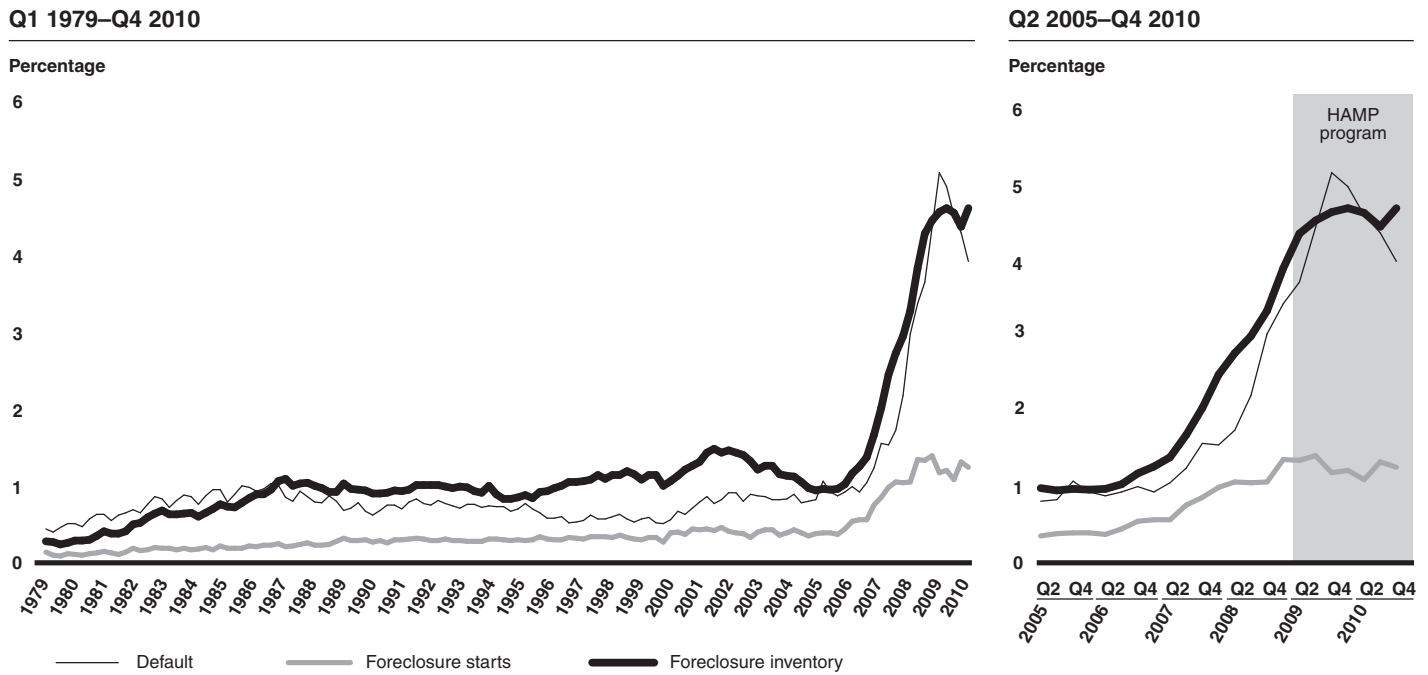
sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives. For additional information on our scope and methodology, see appendix I.

Background

Although default rates (loans 90 days or more past due) fell from an all-time high of 5.09 percent at the end of the fourth quarter of 2009 to 3.94 percent at the end of the fourth quarter of 2010 (a nearly 23 percent drop over the course of a year), the percentage of loans in foreclosure rose to equal the highest level in recent history at 4.63 percent (fig.1).⁶ The increase in foreclosure inventory during the latter part of 2010 may be due to issues surrounding foreclosure processing and procedures that resulted in various foreclosure moratorium initiatives. In addition, the percentage of loans that newly entered the foreclosure process in the fourth quarter of 2010 remained high at 1.27 percent, compared to 0.42 percent in the first quarter of 2005.

⁶The primary source of information on the status of mortgage loans was the Mortgage Bankers Association's (MBA) quarterly National Delinquency Survey, which was estimated to represent about 88 percent of the mortgage market in the fourth quarter of 2010.

Figure 1: National Default and Foreclosure Trends from Calendar Years 1979-2010



Source: GAO analysis of MBA data

As we reported in December 2008, Treasury has established an Office of Homeownership Preservation within the Office of Financial Stability (OFS), which administers TARP, to address the issues of preserving homeownership and protecting home values.⁷ On February 18, 2009, Treasury announced the broad outline of the MHA program. The largest component of MHA was the HAMP first-lien modification program, which was intended to help eligible homeowners stay in their homes and avoid potential foreclosure. Treasury intended that up to \$75 billion would be committed to MHA (\$50 billion under TARP and \$25 billion from Fannie Mae and Freddie Mac) to prevent avoidable foreclosures for up to 3 to 4 million borrowers who were struggling to pay their mortgages. According to Treasury officials, up to \$50 billion in TARP funds were to be used to encourage the modification of mortgages that financial institutions owned and held in their portfolios (whole loans) and mortgages held in private-

⁷GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008).

label securitization trusts.⁸ Fannie Mae and Freddie Mac together were expected to provide up to an additional \$25 billion from their own balance sheets to encourage servicers and borrowers to modify or refinance loans that those two Government Sponsored Enterprises (GSE) guaranteed.⁹ Only financial institutions that voluntarily signed a Commitment to Purchase Financial Instrument and Servicer Participation Agreement (SPA) with respect to their non-GSE loans are eligible to receive TARP financial incentives under the MHA program.

HAMP first-lien modifications are available to qualified borrowers who occupied their properties as their primary residence, who had taken out their loans on or before January 1, 2009, and whose first-lien mortgage payment was more than 31 percent of their gross monthly income (calculated using the front-end debt-to-income ratio (DTI)).¹⁰ Only single-family properties (one-four units) with mortgages no greater than \$729,750 for a one-unit property were eligible.¹¹

The HAMP first-lien modification program has four main features:

1. *Cost sharing.* Mortgage holders/investors are required to take the first loss in reducing the borrower's monthly payments to no more than 38 percent of the borrower's income. For non-GSE loans, Treasury then

⁸Loans held in private-label securitization trusts include loans not securitized by Fannie Mae or Freddie Mac, and not insured or guaranteed by the Department of Housing and Urban Development's (HUD) FHA, the Department of Veterans Affairs (VA), or the U.S. Department of Agriculture's (USDA) Rural Housing Loan Program. Loans guaranteed by HUD's Federal Housing Administration (FHA) and the USDA Rural Housing Service are eligible for TARP incentives when modified under requirements issued by those agencies. The \$50 billion was intended to be used for loan modifications and other foreclosure prevention activities.

⁹Any funds that Treasury provides to the GSEs Fannie Mae and Freddie Mac under the preferred stock purchase agreements will, like TARP programs, be funded through the issuance of public debt. Treasury will also issue public debt to cover any losses that the GSEs incur because of the additional \$25 billion they provide, as long as the GSEs have liabilities that exceed assets.

¹⁰The front-end DTI ratio used for the HAMP program is the percentage of a borrower's gross monthly income required to pay the borrower's monthly housing expense which is comprised of mortgage principal, interest, taxes, insurance, and if applicable, condominium, co-operative, or homeowners' association dues.

¹¹Unpaid principal balance limits (prior to modification) are \$729,750 for a one-unit building; \$934,200 for a two-unit building; \$1,129,250 for a three-unit building; and \$1,403,400 for a four-unit building.

uses TARP funds to match further reductions on a dollar-for-dollar basis, down to the target of 31 percent of the borrower's gross monthly income. The modified monthly payment is fixed for 5 years or until the loan is paid off, whichever is earlier, as long as the borrower remains in good standing with the program. After 5 years, investors no longer receive payments for cost sharing, and the borrower's interest rate may increase by 1 percent a year to a cap that equals the Freddie Mac rate for 30-year fixed rate loans as of the date that the modification agreement was prepared. The borrower's payment would increase to accommodate the increase in the interest rate, but the interest rate and monthly payments would then be fixed for the remainder of the loan.

2. *Standardized net present value (NPV) model.* The NPV model compares expected cash flows from a modified loan to the same loan with no modification, using certain assumptions. If the expected investor cash flow with a modification is greater than the expected cash flow without a modification, the loan servicer is required to modify the loan. According to Treasury, the NPV model increases mortgage investors' confidence that modifications under HAMP are in their best financial interests and helps ensure that borrowers are treated consistently under the program by providing an externally derived objective standard for all loan servicers to follow.
3. *Standardized waterfall.* Servicers must follow a sequential modification process to reduce payments to as close to 31 percent of gross monthly income as possible. Servicers must first capitalize accrued interest and certain expenses paid to third parties and add this amount to the loan balance (principal) amount. Next, the interest rate must be reduced in increments of one-eighth of 1 percent until the 31 percent DTI target is reached, but servicers may not reduce interest rates below 2 percent. If the interest rate reduction does not result in a DTI ratio of 31 percent, servicers must then extend the maturity and/or amortization period of the loan in 1-month increments up to 40 years. Finally, if the target DTI ratio is still not reached, the servicer must forbear, or defer, principal until the payment is reduced to the 31 percent target. Servicers may also forgive mortgage principal at any

step of the process to achieve the target monthly payment ratio of 31 percent, provided that the investor allows principal reduction.¹²

4. *Incentive payment structure.* Treasury uses TARP funds to provide both one-time and ongoing incentives (“pay-for-success”) for up to 5 years to non-GSE loan servicers, mortgage investors, and borrowers. These incentives are designed to increase the likelihood that the program will produce successful modifications over the long term and help cover the servicers’ and investors’ costs for making the modifications.

Borrowers must also demonstrate their ability to pay the modified amount by successfully completing a trial period of at least 90 days before a loan is permanently modified and any government payments are made under HAMP. Treasury has entered into agreements with Fannie Mae and Freddie Mac to act as its financial agents for MHA. With respect to Freddie Mac, these responsibilities are carried out by a separate division of that entity. Fannie Mae serves as the MHA program administrator and is responsible for developing and administering program operations including registering servicers and executing participation agreements with and collecting data from them, as well as providing ongoing servicer training and support. Within Freddie Mac, the MHA-Compliance (MHA-C) team is the MHA compliance agent and is responsible for assessing servicers’ compliance with non-GSE program guidelines, including conducting on-site and remote servicer loan file reviews and audits.

Initially, only servicers who signed a SPA prior to December 31, 2009, were eligible to participate in MHA. Subsequently, the Secretary of the Treasury exercised the authority granted under the Emergency Economic Stabilization Act of 2008 to extend TARP’s obligation authority to October 3, 2010, which allowed servicers to continue to sign SPAs to participate in MHA until that time. As of December 31, 2010, there were a total of 143

¹²The principal forbearance amount is noninterest-bearing and nonamortizing and cannot accrue interest under the HAMP guidelines or be amortized over the loan term. Rather, the amount of principal forbearance will result in a balloon payment fully due and payable upon the borrower’s transfer of the property, payoff of the interest-bearing unpaid principal balance, or maturity of the mortgage loan. If, in order to reach the target DTI ratio, the investor will be required to forbear more than 30 percent of the unpaid principal balance, or an amount of principal necessary to reach 100 percent of the mark-to-market loan-to-value ratio (MLTV), the servicer may, but is not required to modify the loan.

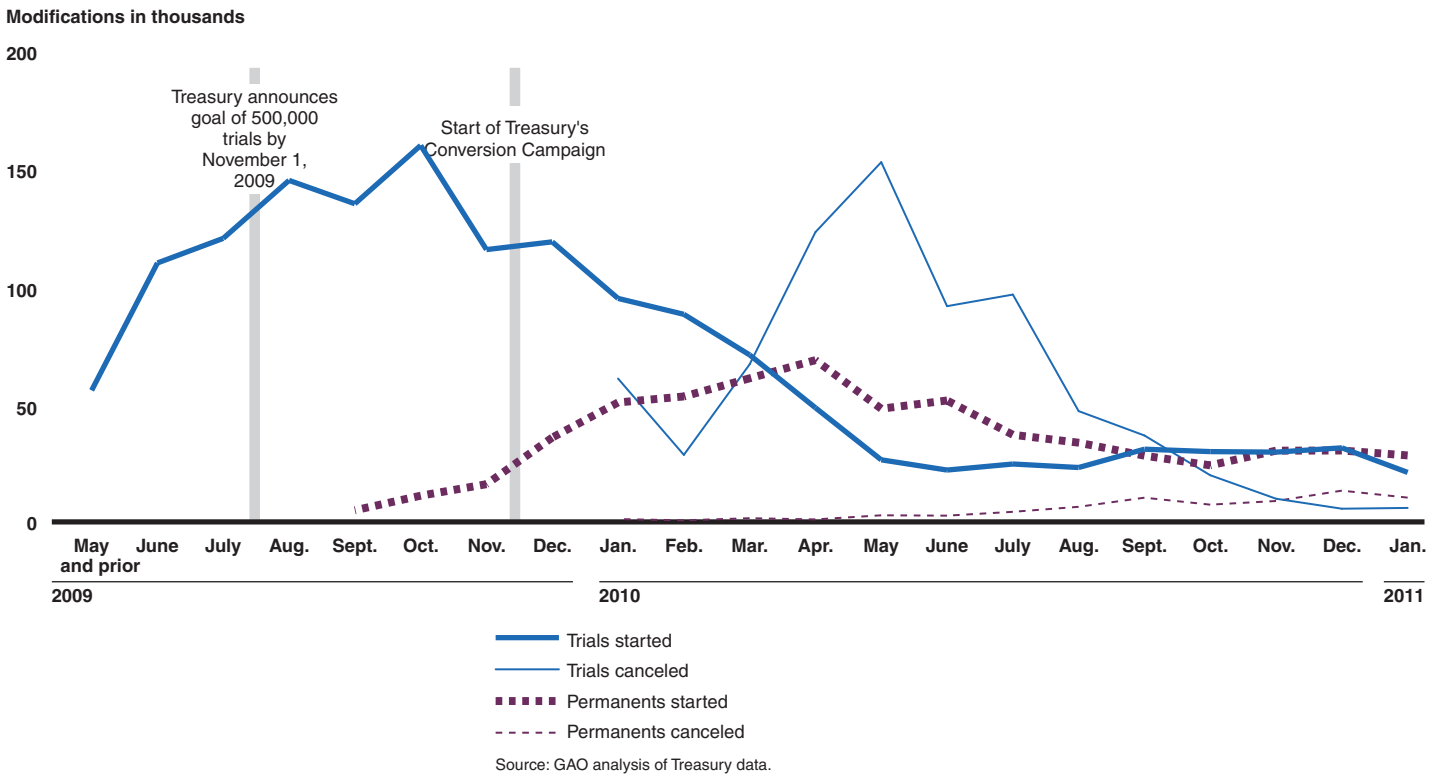
active servicers.¹³ Through January 2011, \$29.9 billion in TARP funds had been committed to these servicers for modification of non-GSE loans.¹⁴ Based on the MHA Servicer Performance Report through January 2011, nearly 1.8 million HAMP trial modifications had been offered to borrowers of GSE and non-GSE loans as of the end of January 2011, and nearly 1.5 million of these had begun HAMP trial modifications.¹⁵ Of the trial modifications begun, approximately 145,000 were in active trial modifications, roughly 539,000 were in active permanent modifications, roughly 740,000 trial modifications had been canceled, and roughly 68,000 permanent modifications had been canceled. Recently, the number of new trial and permanent modifications started each month has declined (fig. 2). As of December 31, 2010, \$1 billion in TARP funds had been disbursed for TARP-funded housing programs, of which \$840 million was disbursed for HAMP-related activity.

¹³The GSEs have directed all of their approximately 2,000 servicers to implement parallel HAMP programs on first-lien mortgages owned or guaranteed by the GSEs.

¹⁴The balance of the difference between this amount and the \$45.6 billion allocated to housing programs was allocated to the FHA Short Refinance Program and the HFA Hardest-Hit Fund.

¹⁵Roughly 46 percent of borrowers who were either in trial or permanent modifications as of September 30, 2010, had non-GSE loans and, therefore, fell under the TARP-funded portion of HAMP.

Figure 2: GSE and Non-GSE HAMP Trial and Permanent Modifications Made and Canceled Each Month, through January 2011



Implementation of Treasury's Newer Housing Programs Has Been Slow and Capacity of Servicers to Carry Out These Programs Remains Unclear, Raising Uncertainty About the Potential Impact of These Programs

Treasury has recently implemented programs to reduce or eliminate payments on second-lien mortgages, provide incentives for the use of short sales or deeds-in-lieu as alternatives to foreclosure, and provide incentives for the forgiveness of principal for borrowers whose homes are worth significantly less than their mortgage balances. However, as of December 2010, reported activity under these three programs had been limited.¹⁶

- 2MP was announced in March 2009, and had disbursed \$2.9 million out of nearly \$133 million allocated to the program by the end of December 2010. In part, the limited activity appears to be the result of problems that servicers have experienced using the database that Treasury required to identify second-lien mortgages eligible for modification. Treasury has taken some steps to address these challenges, but could take further action to ensure that borrowers are aware of their potential eligibility for the program.
- HAFA was announced in March 2009 and had disbursed \$9.5 million out of \$4.1 billion allocated to the program by the end of December 2010. Restrictive program requirements—for example, that borrowers be evaluated for a HAMP first-lien modification before being evaluated for HAFA, appear to have limited program activity to date. Treasury has taken steps to revise program guidelines, but it remains to be seen the extent to which these actions will result in increased program activity.
- PRA was announced in March 2010 and Treasury had not reported activity as of December 2010 for this \$2 billion program. Mortgage investors and others have cited concerns that the voluntary nature of the program and transparency issues, including concerns about the extent of reporting on PRA activity, may limit the extent to which servicers implement PRA. Treasury has not yet implemented our June 2010 recommendation that it report activity under PRA, including the extent to which servicers determined that principal reduction was beneficial to investors but did not offer it, to ensure transparency in the implementation of this program feature across servicers.

¹⁶In commenting on a draft of this report, Treasury noted that participating servicers were matching HAMP first liens with second liens in their portfolio, and by December 31, 2010, had generated over 200,000 matches, which they were in the process of modifying.

Further, Treasury has not incorporated key lessons learned from implementation challenges it faced with the first-lien program.¹⁷ Similar to the first-lien modification program, Treasury has not established effective performance measures for these three programs, including goals for the number of borrowers it expects to help. As a result, determining the progress and success of these programs in preserving homeownership and protecting home values will be difficult.

Challenges in Matching First- and Second-Lien Mortgage Data and Potential Lack of Awareness of the Program Have Slowed Implementation of the Second-Lien Modification Program

Under 2MP, Treasury provides incentives for second-lien holders to modify or extinguish a second-lien mortgage when a HAMP modification has been initiated on the first-lien mortgage for the same property. Treasury requires servicers who agree to participate in the 2MP program to offer to modify the borrower's second lien according to a defined protocol when the borrower's first lien is modified under HAMP. That protocol provides for a lump-sum payment from Treasury in exchange for full extinguishment of the second lien or a reduced lump-sum payment for a partial extinguishment and modification of the borrower's remaining second lien. The modification steps for 2MP are similar to those for HAMP first-lien modifications, with the interest rate generally reduced to 1 percent and the loan term generally extended to match the term of the HAMP-modified first lien. In addition, if the HAMP modification on the first lien included principal forgiveness, the 2MP modification must forgive principal in the same proportion. Servicers were required to sign specific agreements to participate in 2MP. As of November 2010, 17 servicers were participating in the program, covering nearly two-thirds of the second-lien mortgage market.

According to Treasury, 2MP is needed to create a comprehensive solution for borrowers struggling to make their mortgage payments, but Treasury officials we interviewed told us that the pace of 2MP modifications had been slow. Of the six servicers we contacted, five had signed 2MP participation agreements and represented the majority of potential second liens covered by servicers participating in the program.¹⁸ Only one of these five servicers had begun 2MP modifications as of the date we collected information from these servicers—over 18 months after the program was

¹⁷See [GAO-10-634](#) for a discussion of the implementation challenges associated with the HAMP first-lien modification program.

¹⁸The remaining servicer told us that it had not signed a 2MP participation agreement since second liens represented only a small portion of the loans it serviced.

first announced by Treasury. This servicer reported that it had started 1,334 second-lien modifications. As of January 2011, Treasury had not yet begun reporting activity under 2MP. According to servicers and Treasury officials, the primary reason for the slow implementation of 2MP has been challenges in obtaining accurate matches of first and second liens from the data vendor required by Treasury. Treasury's 2MP guidelines specify that in order for a second lien to be modified under 2MP, the corresponding first lien must first have been modified under the HAMP first-lien modification program. Fannie Mae, as the MHA program administrator, has contracted with a mortgage loan data vendor—Lender Processing Services (LPS)—to develop a database that would inform second-lien servicers when the corresponding first lien had been modified under HAMP. LPS was also the data vendor used by Fannie Mae to process the loan level data reported by servicers for the HAMP first-lien program. Under 2MP, participating servicers agree to provide LPS with information regarding all eligible second liens they serviced. LPS, in turn, provides participating 2MP servicers with data on second liens that have had the borrowers' corresponding first-lien mortgages modified under the HAMP program. However, the five participating 2MP servicers we spoke with all expressed concerns about the completeness or accuracy of LPS' data. In particular, they noted that differences in the spelling of addresses—for example, in abbreviations or spacing—could prevent LPS from finding matches between first and second liens. Additionally, another servicer reported that first-lien data could be incorrectly reported in LPS—for example, in one case, a borrower was incorrectly reported as not in good standing and, subsequently, was reported as canceled from HAMP. This mistake prevented the borrower's first and second liens from being matched, even though the borrower was in good standing and eligible for 2MP. Treasury has also acknowledged that an inability to identify first- and second-lien matches poses a potential risk to the successful implementation of 2MP.

Initial 2MP guidelines stated that servicers could not offer a second-lien modification without a confirmation of a match from LPS, even if they serviced both first and second liens on the same property and, thus, would know if the first lien had been modified under HAMP. In November 2010 Treasury provided updated program guidance that revised the match requirement if servicers serviced both the first and second lien on a property. According to these updated guidelines, servicers can offer a 2MP modification when they identify a first- and second-lien match within their own portfolio or if they have evidence of the existence of a corresponding first lien, even if the LPS database has not identified it. While this change may enable more 2MP modifications, Treasury did not release this

guidance until after participating servicers had already begun implementing 2MP, more than a year after the program's guidelines were first announced in August 2009.

If they do not service both liens, second-lien servicers must rely on LPS for matching data or obtain sufficient documentation of the HAMP first-lien modification to identify the match. If the matching data provided by LPS is not accurate, it is possible that eligible borrowers will not receive second-lien modifications. Treasury noted that there are no standard data definitions in the servicing industry, making it difficult to match these data across servicers. To address some of the concerns about inaccurate and incomplete matches, Treasury officials told us they worked with LPS to change the matching protocols. Now LPS provides 2MP servicers with a list of confirmed address matches and a separate list of probable matches based only on loan number and zip code. Treasury told us that it would issue additional guidance for handling probable matches, but added that servicers would be responsible for confirming probable matches with LPS.

Treasury does not require first-lien servicers to check credit reports to determine if borrowers whose first liens they modified also had second liens, and if so, the identity of the second-lien servicer. One servicer noted that credit reports did not always have complete and reliable information. In addition, Treasury does not require first-lien servicers to inform borrowers about their potential eligibility for the second-lien program. Therefore, borrowers may be unaware that their second lien could be modified and unlikely to inquire with their second-lien servicers about a second-lien modification. Any gaps in the awareness of 2MP could contribute to delays in modifying eligible second-lien mortgages or missed opportunities altogether. Additionally, any delays or omissions increase the likelihood that the borrower with an eligible second lien may not be able to maintain the required monthly reduced payments on the modified first- and unmodified second-lien mortgages and ultimately redefault on their HAMP first-lien modification.

Treasury Has Taken Some Recent Steps to Address Requirements That May Have Been Affecting Participation in the Foreclosure Alternatives Program

Under HAFA, Treasury provides incentives for short sales and deeds-in-lieu of foreclosure as alternatives to foreclosure for borrowers who are unable or unwilling to complete the HAMP first-lien modification process.¹⁹ Borrowers are eligible for relocation assistance of \$3,000 and servicers receive a \$1,500 incentive for completing a short sale or deed-in-lieu of foreclosure. In addition, investors are paid up to \$2,000 for allowing short-sale proceeds to be distributed to subordinate lien holders. Servicers who participate in the HAMP first-lien modification program are required to evaluate certain borrowers for HAFA—those whom they cannot approve for HAMP because, for example, they do not pass the NPV test or have investors that prohibit modifications; those who do not accept a HAMP trial modification; and those who default on a HAMP modification.

All six of the large MHA servicers we spoke with identified extensive program requirements as reasons for the slow implementation of the program, including the requirement in the initial guidance that borrowers first be evaluated for a HAMP first-lien modification. Restrictive short-sale requirements, and a requirement that mortgage insurers waive certain rights may have also contributed to the limited activity under HAFA. As a result, they said they did not expect HAFA to increase their overall number of short sales and deeds-in-lieu. Some of the program requirements identified by servicers as a reason for the slow implementation of the program were recently addressed by Treasury's December 28, 2010, revisions to its HAFA guidelines.

- *Borrowers had to first be evaluated for HAMP.* According to Treasury's initial guidelines, borrowers were to be evaluated for a HAMP first-lien modification before being considered for HAFA, even borrowers who specifically requested a short sale or deed-in-lieu rather than a modification. As such, borrowers interested in HAFA had to submit all income and other documentation required for a HAMP first-lien modification. According to servicers we interviewed, this requirement was more stringent than most proprietary short-sale requirements, and borrowers may have had difficulty providing all of the documentation

¹⁹Under a deed-in-lieu of foreclosure, the homeowner voluntarily conveys all ownership interest in the home to the lender as an alternative to foreclosure proceedings. In a short sale, a house is sold by the homeowner through a real estate agency or other means, rather than through foreclosure, and the proceeds of the sale are less than what the homeowner still owes on the mortgage. The lender must give permission to such a transaction and can agree to forgive the shortfall between the loan balance and the net sale proceeds. Under HAFA, accepting a deed-in-lieu must satisfy the borrower's entire mortgage obligation in addition to releasing the lien on the subject property.

required. For example, one servicer told us that it evaluated borrowers for proprietary short sales on the basis of the value of the property and the borrower's hardship and that income documentation was not required. Additionally, a HAMP evaluation may add extra time to the short-sale process. In cases where a borrower had already identified a potential buyer before executing a short-sale agreement with the servicer, the additional time required for a HAMP first-lien evaluation may have dissuaded the buyer from purchasing the property.

In response to this concern, Treasury released updated HAFA guidance on December 28, 2010, to no longer require servicers to document and verify a borrower's financial information to be eligible for HAFA. The updated guidance requires servicers to notify borrowers who request a short sale before they have been evaluated for HAMP about the availability of HAMP, but no longer requires the servicer to complete a HAMP evaluation before considering the borrower for HAFA, especially in circumstances where the borrower already has a purchaser for the property. As a result, borrowers who specifically request a short sale or deed-in-lieu can be considered for HAFA at the start of the HAMP evaluation process, rather than having to wait until the completion of the HAMP evaluation process.²⁰

- *Restrictive short-sale requirements.* According to servicers we spoke with, some HAFA short-sale requirements, such as occupancy requirements, may have been too restrictive. Specifically, one servicer cited as too restrictive the requirement in the initial guidelines that a property not be vacant for more than 90 days prior to the date of the short-sale agreement, and that if it is vacant, it is because the borrower relocated at least 100 miles away to accept new employment. To address this concern, Treasury issued updated guidance in December 2010 which extended the allowed vacancy period from 90 days to 12 months and eliminated the requirement that the borrower moved to accept employment, but added a requirement that the borrower had not purchased other residential property within the prior 12 months. Owner-occupancy restrictions may also limit the number of HAFA short sales and deeds-in-lieu. One servicer noted that many of the short sales it completed outside of HAFA were for nonowner-occupied properties, which may include second homes or commercial properties. However, HAFA offers

²⁰Treasury's revised guidelines continue to require servicers to verify the borrower's financial hardship by obtaining a signed Hardship Affidavit or Request for Modification and Affidavit, official documents used in the HAMP first-lien modification program.

alternatives to foreclosure only for eligible loans under HAMP, which is intended for a property serving as a borrower's principal residence.

- *Waiving of rights by mortgage insurers to collect additional sums.* According to Treasury guidelines, "a mortgage loan does not qualify for HAFA unless the mortgage insurer waives any right to collect additional sums (cash contribution or a promissory note) from the borrower."²¹ Some servicers noted that this requirement had prevented some HAFA short sales from being completed due to difficulties in obtaining approval for HAFA short sales from mortgage insurers. Lenders frequently require mortgage insurance for loans that exceed 80 percent of the appraised value of the property at the time of origination. Under a short-sale scenario, the mortgage insurance company could be responsible for paying the mortgage holder or investor for all or part of the losses incurred under the short sale depending upon the coverage agreement and proceeds from the sale.

Mortgage insurance representatives we spoke with indicated that while they supported HAFA participation, they felt that mortgage insurers should not have to waive their rights to collect additional sums if borrowers had some ability to pay them. These representatives told us that they had not seen many requests for approvals of HAFA foreclosure alternatives, so they did not believe this requirement was a key impediment for HAFA. However, they agreed that because servicers did not know whether mortgage insurers would agree to waive their rights, the requirement could make it more difficult to solicit borrowers for HAFA. To minimize the impact of this requirement, one mortgage insurance representative noted that his company commits to responding to servicers within 48 hours with a decision about whether the mortgage insurance company agrees to forego a contribution from the borrower.

We plan to continue to monitor the progress of the HAFA program, including the impact of Treasury's December 2010 revisions to its HAFA guidelines as well as the other program requirements identified by servicers as contributing to the slow implementation of the program, as part of our ongoing oversight of the performance of TARP.

²¹MHA, *MHA Handbook* (Washington, D.C., Dec. 2, 2010) Section 6.2.1.

Large MHA Servicers Generally Have Agreed to Offer Principal Reductions, but Mortgage Investors Had Concerns about Program Design and Transparency

PRA provides financial incentives to investors who agree to forgive principal for borrowers whose homes are worth significantly less than the remaining amounts owed under their first-lien mortgage loans. Treasury's PRA guidelines require servicers to consider principal forgiveness for any HAMP-eligible borrowers with MLTV greater than 115 percent, using both the standard waterfall and an alternative.²² While servicers must consider borrowers for principal forgiveness, they are not required to offer it, even if the NPV value to modify the loan is higher when principal is forgiven. If they choose to offer forgiveness, servicers must reduce the balance borrowers owe on their mortgages in increments over 3 years, but only if the borrowers remain current on their payments. Servicers must establish written policies to Treasury detailing when principal forgiveness will be offered. According to Treasury, a survey of the 20 largest servicers indicates that 13 servicers are planning to offer principal reduction to some extent.

Of the six servicers we spoke with, three said that they planned to offer principal reduction under the program in all cases in which the NPV was higher with PRA, unless investor restrictions prevented it.²³ As of October 2010, one of these three servicers had begun HAMP trial modifications with PRA, another had begun implementation of PRA but had not yet made trial modification offers with PRA, and the third servicer had not yet completed implementation of the program. The three remaining servicers we spoke with said they would limit the conditions under which they would offer principal forgiveness under the program. One servicer offered PRA only for adjustable-rate mortgage loans, subprime loans, and 2-year hybrid loans, and the other had developed a "second look" process for reviewing loans that had a higher NPV result with principal forgiveness. This servicer reevaluated these loans using its internal estimates of default rates and did not forgive principal unless its own estimates indicated a higher NPV with forgiveness. As a result, only 15 to 25 percent of those

²²The alternative waterfall includes principal reduction as the second step, after capitalization of accrued interest and certain expenses. The mark-to-market LTV is the unpaid principal balance divided by the property value at the time of modification.

²³The NPV 4.0 model is the updated version of the NPV model that went into effect on October 1, 2010, and incorporates PRA. The NPV 4.0 model changed several assumptions from the prior NPV model such as the probability of default based on more recent loan performance information. The NPV 4.0 model calculates the net present value of the modification under the standard HAMP waterfall as well as the alternative waterfall under PRA. The alternative waterfall includes principal reduction as the required second step for all loans with a LTV ratio greater than 115 percent.

who otherwise would have received principal forgiveness will receive it after this “second look” process, according to this servicer. The third servicer said it would not offer PRA for loans that had mortgage insurance, noting that mortgage insurers typically took the first loss on a loan and the PRA would alter that equation with the investor absorbing the full amount of loss associated with the principal reduction.

Four of the six servicers we contacted told us that investor restrictions against principal forgiveness would not limit their ability to offer principal reduction. However, one servicer noted that about half the loans it serviced had investor restrictions against principal forgiveness. Another servicer noted that a material number of its servicing agreements with investors prohibited principal forgiveness.

Mortgage investors we spoke with expressed concern about PRA’s design and transparency. In particular, they expressed concern that because the HAMP NPV model did not use an LTV that reflected both the first and second liens (combined LTV), the model might not reflect an accurate NPV result. That is, the NPV model might underestimate the likelihood of redefault if it did not use the combined LTV. As a result, investors face the prospect of forgiving principal without knowing the true redefault risk. Further, although the purpose of PRA is to address negative equity, not taking the combined LTV into account would underestimate the population of underwater borrowers since it would not account for any associated second liens. In addition, under PRA, servicers must forgive principal on the second lien in the same proportion as the principal forgiven on the first lien. However, mortgage investors expressed concern about limited transparency into whether servicers were forgiving principal on the second lien. Additionally, SIGTARP recommended in July 2010 that Treasury reevaluate the voluntary nature of the program and consider changes to ensure the consistent treatment of similarly situated borrowers.²⁴ According to Treasury, servicers began reporting PRA activity in January 2011 for trial and permanent modifications through December 31, but it is still unclear what level of program detail Treasury will publicly report. We recommended in June 2010 that Treasury report activity under PRA, including the extent to which servicers determined that principal reduction was beneficial to mortgage investors but did not offer it, to ensure transparency in the implementation of this program. Treasury officials told us they would report PRA activity at the servicer level once

²⁴SIGTARP, *Quarterly Report to Congress* (Washington, D.C., July 21, 2010).

the data were available. We plan to continue to monitor Treasury's reporting of PRA and other TARP-funded housing programs.

Treasury Could Do More to Incorporate Lessons Learned from the First-Lien Modification Program in Implementing Newer Programs

In our June 2010 report, we pointed out that it was important that Treasury incorporate lessons learned from the challenges experienced with the HAMP first-lien modification program into the design and implementation of the newer MHA-funded programs.²⁵ In particular, we noted that it would be important for Treasury to expeditiously develop and implement these new programs (including 2MP, HAFA, and PRA) while also developing sufficient program planning and implementation capacity, including providing program policies and guidance, hiring needed staff, and ensuring that servicers are able to meet program requirements. Treasury officials said they solicited input from servicers and investors when designing 2MP, PRA, and HAFA, and have begun to perform readiness reviews for these servicers. However, servicers have cited challenges with changing guidance under these programs. We also noted that Treasury needed to implement appropriate risk assessments and meaningful performance measures in accordance with standards for effective program management. However, Treasury has not completed program-specific risk assessments, nor has it developed performance measures to hold itself and servicers accountable for these TARP-funded housing programs or finalized specific actions it could take in the event servicers fail to meet program requirements.

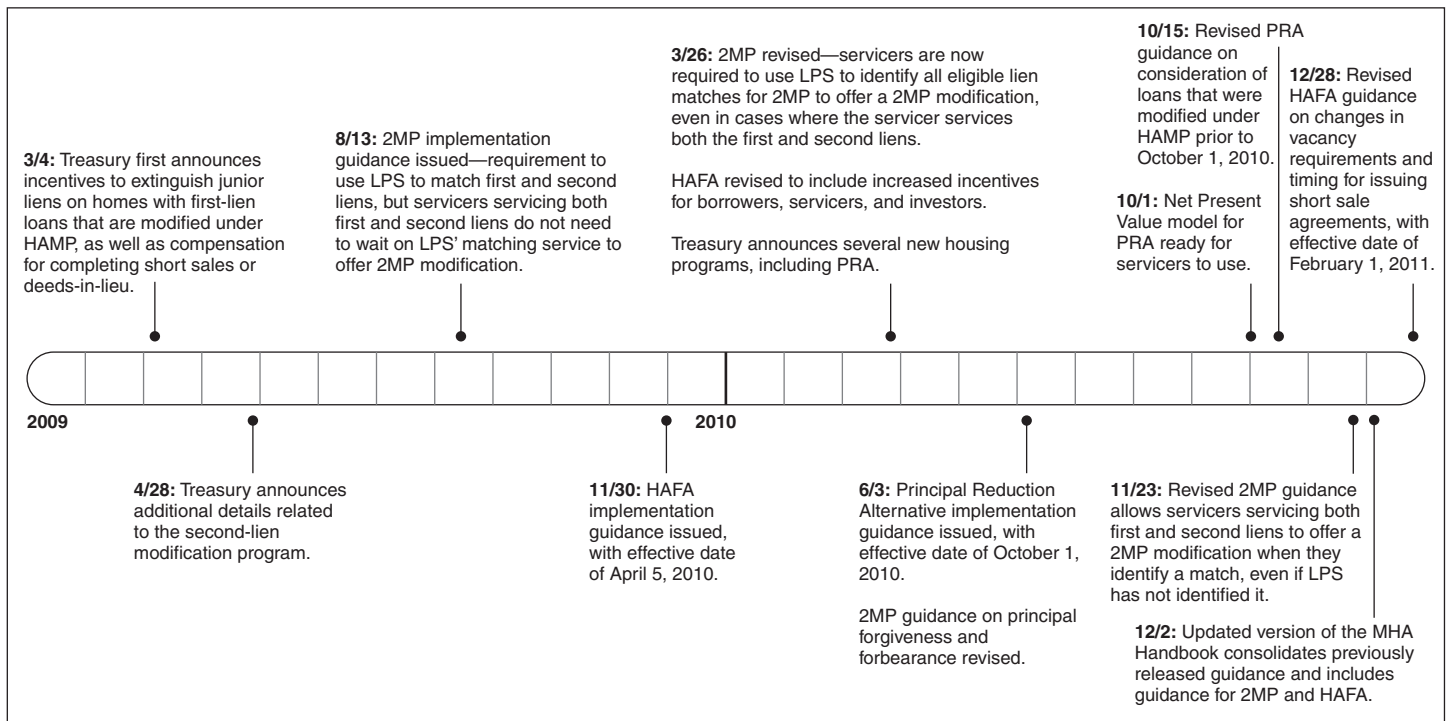
- *Program planning and implementation capacity.* Treasury has provided servicers with some guidance on the new programs, but some servicers said that ongoing changes to the guidelines have presented challenges. In June 2010, we noted that effective program planning included having complete policies, guidelines, and procedures in place prior to program implementation.²⁶ Treasury published initial guidance for 2MP, HAFA, and PRA prior to the dates these programs were effective, and some servicers indicated that implementation of these newer programs was smoother than it was with the first-lien modification program (see fig. 3). However, other servicers indicated that initial program guidance was unclear and that additional guidance was issued late in the implementation process. For example, while Treasury first announced the 2MP program in March 2009, it did not publish specific 2MP guidelines until August 2009 and then

²⁵ [GAO-10-634](#).

²⁶ [GAO-10-634](#).

issued revisions to the guidelines in March 2010, the first month of official implementation, with revisions in June 2010 and again in November 2010. According to the servicers we contacted, ongoing program revisions presented challenges such as needing to retrain staff and, in some cases, delayed program implementation. Treasury officials noted that issuing additional guidance improves the program and is often necessary as circumstances change. Servicers also reported that while initial guidance for PRA was issued before the effective date of the program, Treasury did not issue guidance specific to the NPV 4.0 model until October 1, 2010, the date PRA became effective. As a result, servicers told us that there was insufficient time to update internal servicing systems in time to implement PRA as of its effective date.

Figure 3: Timeline of 2MP, HAFA, and PRA Guidance



Source: GAO.

Treasury has also not completed a needed workforce assessment to determine whether it has enough staff to successfully implement the new program. In July 2009, we recommended that Treasury place a high priority on fully staffing vacancies in its Homeownership Preservation Office (HPO), the office within Treasury responsible for MHA governance,

and fill all necessary positions. According to Treasury officials, each director within HPO conducts ongoing informal assessments of staffing needs, and Treasury has recently added two positions in marketing and communications, as well as two additional staff to address policies regarding the borrower complaint process. In addition, two additional staff positions to support the borrower complaint resolution process have recently been approved by the staffing board. HPO has also named a Deputy Chief. In addition, Treasury officials told us that Fannie Mae and Freddie Mac, Treasury's financial agents for MHA, had doubled the number of staff devoted to these functions as the complexity of MHA has increased. However, as of December 2010, Treasury had not conducted a formal workforce assessment of HPO, despite the addition of the new MHA programs, 2MP, HAFA, and PRA. As we noted in July 2009, given the importance of HPO's role in monitoring the financial agents, servicers, and other entities involved in the \$45.6 billion TARP-funded housing programs, having enough staff with appropriate skills is essential to governing the program effectively.

Servicers have not demonstrated full capacity to effectively carry out these programs. Treasury has previously stated that the implementation of the HAMP first-lien program was hindered by the lack of capacity of servicers to implement all of the requirements of the program. According to Treasury, Fannie Mae has conducted program-specific readiness reviews for the top 20 large servicers for HAFA and PRA, including all 17 servicers participating in 2MP. These reviews assess servicers' operational readiness, including developing key controls to support new programs, technology readiness, training readiness, as well as staffing resources and program processes and documentation. According to Treasury officials, 5 servicers have completed readiness reviews for 2MP, and 5 additional servicers were scheduled to be surveyed in January 2011; 19 servicers have completed these reviews for HAFA; and 18 servicers have completed these reviews for PRA. According to Treasury's summary of these reviews, a large majority of servicers completing these readiness reviews did not provide all documentation required to demonstrate that the key tasks needed to support these programs were in place at the time of the review. Of those that had complete reviews, 4 had provided all required documents for HAFA and 3 had provided all required documents for PRA. None of the servicers provided all required documents for 2MP. Treasury notes that it relies on Fannie Mae to monitor program readiness and that MHA-C reviews all programs as part of its on-site reviews. Nonetheless, it is unclear what actions Treasury has taken to ensure that the servicers who did not submit the required documentation have the capacity to effectively implement the programs, making less certain the ability of

these servicers to fully participate in offering troubled homeowners second-lien modifications, principal reduction, and foreclosure alternatives.

- *Meaningful performance measures and remedies.* As we also reported in June 2010, Treasury must establish specific and relevant performance measures that will enable it to evaluate the program's success against stated goals in order to hold itself and servicers accountable for these TARP-funded programs. While Treasury has established program estimates of the expected funding levels for 2MP, HAFA, and PRA programs, it has not fully developed specific and quantifiable servicer-based performance measures or benchmarks to determine the success of 2MP, HAFA, and PRA, including goals for the number of homeowners these programs are expected to help. Treasury officials told us that they were using the amounts of TARP funds allocated to MHA servicers to determine estimated participation rates, but this estimate is adjusted on a quarterly basis and according to Treasury, is not the best measure for holding servicers accountable. Treasury officials stated that when data became available they would assess certain aspects of program performance—for example, they noted that Treasury planned to assess the redefault rates of modifications that received PRA or 2MP, compared with those that did not. However, Treasury has not set benchmarks, or goals, for these performance measures, as we recommended in June 2010. In addition, Treasury has not stated how it will use these assessments to hold servicers accountable for their performance or what remedial actions it will take in cases where individual servicers are not performing as expected in these programs. We continue to believe that Treasury should take steps to establish benchmarks that can be used to hold servicers accountable for their performance.
- *Appropriate risk assessment.* We previously reported that agencies must identify the risks that could impede the success of new programs and determine appropriate methods of mitigating these risks. In particular, we highlighted the need for Treasury to develop appropriate controls to mitigate those risks before the programs' implementation dates. Although Treasury has not systematically assessed risks at the program level, Treasury officials told us they had identified several risks associated with 2MP, HAFA, and PRA and specified ways to mitigate these risks, and added they were planning to begin new risk assessments in January 2011 that would be completed by June 2011. According to Treasury officials, this new round of risk assessments will include 2MP, HAFA, and PRA, but the programs will not be evaluated individually.

In addition, Treasury has not yet fully addressed all program-specific risks. As we have seen, Treasury has acknowledged the risk that the matching database for 2MP may not identify all first liens modified under HAMP. While Treasury began addressing this issue in updated guidance released in November 2010, it cannot yet determine whether all borrowers eligible for 2MP are being identified and considered for second-lien modifications. Treasury has also acknowledged several potential risks with all types of short-sale transactions, including HAFA transactions. According to Treasury officials, these risks include those arising from sales to allied parties, side agreements, and rapid resales. For example, Treasury officials noted a short-sale purchaser could be inappropriately related to the servicer, allowing the short sale to be inappropriately engineered to generate extra compensation for one or both parties. Treasury states that HAFA includes requirements to mitigate these risks, such as requiring arms-length transactions. According to Treasury officials, MHA-C, the group within Freddie Mac that acts as Treasury's financial agent for MHA compliance activity, is also in the process of developing compliance procedures to address these risks. Further, Treasury has identified several potential risks with PRA, including servicer noncompliance with PRA requirements, moral hazard (the risk that borrowers would default on their mortgages to receive principal reduction when they otherwise would not have), and low program participation. According to Treasury officials, these risks will be mitigated through regular compliance reviews, servicer reporting of NPV results both with and without PRA, and other program requirements. For example, to guard against moral hazard, Treasury requires that borrowers be experiencing hardship and that servicers forgive the principal over 3 years only if the borrower remains current on the modified payments. However, low program participation may continue to be a risk for PRA, despite the initial participation plans of several of the large servicers. While Treasury officials told us they plan to monitor the reasonableness of the extent of principal forgiveness on a servicer-specific basis, we continue to believe that due to the voluntary nature of the program, Treasury will need to ensure full and accurate servicer-specific reporting of program activity for future assessments of the extent to which servicers are offering PRA when the NPV is higher with principal forgiveness, as we recommended in June 2010. We plan to continue to monitor and report on Treasury's risk assessment and control activities for MHA programs as part of our ongoing oversight of Treasury's use of TARP funds to preserve homeownership and protect property values.

Treasury Has Some Data on the Characteristics of Borrowers in HAMP's First-Lien Program, but Data Were Sometimes Missing or Questionable

Our analysis of Treasury's HAMP data through September 30, 2010, indicated that borrowers who entered into trial modifications or received permanent modifications continued to have elevated levels of debt, as evidenced by the median back-end DTI for these two groups (55 and 57 percent, respectively).²⁷ Borrowers who received a trial modification based on stated (unverified) income—a practice that Treasury no longer permits—were the most likely to have their trial modifications canceled, and borrowers who were the most delinquent on their mortgage payments at the time of applying for a loan modification were the most likely to redefault on their modifications. While the data Treasury collected from the servicers provided these and other insights into the characteristics of borrowers helped under the program, some data were missing and some information was inaccurate, preventing certain types of analyses of HAMP borrowers. For example, race and ethnicity information was not available for a significant portion of borrowers. In addition, Treasury's data on borrowers' LTV ratios at the time of modification ranged from 0 to 999, with 1 percent of non-GSE borrowers in active permanent modifications reporting ratios over 400 percent, implying that some borrowers who received HAMP modifications did not have a mortgage, and others had loan amounts more than 4 times the value of their homes. Treasury said that it and Fannie Mae were continuing to refine and strengthen data quality checks and that the data would improve over time.

Certain Factors Increase the Likelihood of Trial Modification Cancellation and Early Data Indicate that Borrowers Who Redefaulted from Permanent Modifications Were Further Into Delinquency

According to Treasury's HAMP data, 88,903 non-GSE borrowers were in active HAMP trial modifications and 205,449 borrowers were in permanent modifications as of the end of September 2010. These borrowers generally cited a reduction in income as their primary reason for hardship when applying for HAMP modifications.

- Over half of borrowers cited a “curtailment of income,” such as a change to a lower-paying job, as the primary reason they were experiencing financial hardship (56 percent and 53 percent of those in active trial and permanent modifications, respectively). However, only 5 percent of borrowers in each of these groups cited unemployment as their primary reason for hardship.

²⁷Back-end DTI ratio consists of items included in the front-end DTI (principal, interest, taxes, insurance, and any homeowners' association or condominium fees associated with the first-lien mortgage and property) and all other monthly debt payments (installment debts, payments on junior liens, alimony, car payments, etc.).

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- Borrowers in trial and permanent modifications through September 2010 also had high levels of debt prior to modification—median front-end DTI ratios of 45 and 46 percent, and back-end DTI ratios of 72 and 76 percent, respectively. Even after modification, these borrowers continued to have high debt levels (median back-end DTI ratios of 55 and 57 percent for those in trial and permanent modifications, respectively). Treasury has defined a high back-end DTI to be 55 percent, and has required borrowers with total postmodification debt at this level to obtain counseling.
 - In addition, borrowers in trial and permanent modifications tended to be “underwater,” with median mark-to-market LTV ratios of 123 percent and 128 percent, respectively.

Borrowers who were unsuccessful in HAMP modifications, either because they were canceled from a trial modification or because they redefaulted from permanent modifications, shared several of these characteristics, including having high levels of debt and being “underwater” on their mortgages. However, some characteristics appeared to increase the likelihood that a borrower would be canceled from a trial modification. Holding other potential factors constant, the following factors increased the likelihood that a borrower would be canceled from a trial modification:

- *Use of Stated Income.* Borrowers who received a trial modification based on stated income were 52 percent more likely to be canceled from trial modifications than those who started a trial modification based on documented income. In some cases, borrowers who received trial modifications based on stated income were not able to or failed to provide proof of their income or other information for conversion to permanent modification.²⁸ In other cases, borrowers may have submitted the required documentation but the servicer lost the documents. Over one-third of the 396 housing counselors who responded to our survey identified servicers losing documentation as the most common challenge that borrowers have faced in providing the required documentation for a permanent modification. In December 2010, the Congressional Oversight Panel also

²⁸Treasury has recognized challenges with documentation as a reason for the low conversion rate to permanent modifications and, as of June 2010, began requiring that servicers verify borrowers’ income before placing borrowers into trial modifications.

reported that Treasury has failed to hold loan servicers accountable when they have repeatedly lost borrowers' paperwork.²⁹

- *Length of Trial Period.* Borrowers who were in trial modification periods for fewer than 4 months were about 58 percent more likely to have their trial modifications canceled than borrowers in longer trial periods. This finding may indicate that borrowers who default on their trial modifications will do so earlier in the process rather than later.
- *Delinquency Level at Time of Modification.* Borrowers who were 60 or 90 days or more delinquent at the time of their trial modifications were 6 and 9 percent more likely to have trial modifications canceled, respectively, compared with borrowers who were not yet delinquent at the time of their trial modifications. Treasury has acknowledged the importance of reaching borrowers before they are seriously delinquent by requiring servicers to evaluate borrowers still current on their mortgages for imminent default, but as we noted in June 2010, this group of borrowers may be defined differently by different servicers.³⁰ In addition, most borrowers who received HAMP were delinquent on their mortgages at the time of modification—as of September 30, 2010, 83 percent of those who had begun trial or permanent modifications were at least 60 days delinquent on their mortgages.

According to our analysis, there were also several factors that lowered the likelihood of trial cancellations, although the effect was generally smaller than the factors that increased the likelihood of being canceled.

- *High MLTV Ratio.* Borrowers who had high MLTV ratios (above 120 percent) were less likely to be canceled from a trial modification compared to those with MLTV ratios at or below 80 percent. That is, loans with a MLTV between 120 and 140 percent were 7 percent less likely to be canceled, while loans with an MLTV of more than 140 percent were 8 percent less likely to be canceled.
- *Amount of Principal or Payment Reduction:* While only about 2 percent of borrowers had received principal forgiveness as of September 30, 2010, borrowers who received principal forgiveness of at least 1 percent of their total loan balance were less likely to be canceled from trial modifications,

²⁹Congressional Oversight Panel, *December Oversight Report: A Review of Treasury's Foreclosure Prevention Programs* (Washington, D.C., Dec. 14, 2010).

³⁰[GAO-10-634](#).

compared with those who did not receive principal forgiveness. In addition, larger monthly payment reductions lowered the likelihood that a trial modification would be canceled. For example, our analysis showed that borrowers who received a principal and interest payment reduction of at least 10 percent were less likely to be canceled from their trial modifications than borrowers who received a payment reduction of less than 10 percent or who had an increase in payments.

Figure 4 illustrates the extent to which certain factors increase or decrease likelihood of borrowers being canceled from HAMP trial modification. See appendix II for further details on our analysis of factors affecting the likelihood of trial modification cancellation.

Figure 4: Estimated Decrease/Increase in Likelihood of Cancellation of HAMP Trial Modification by Borrower and Loan Characteristics

Characteristics	Change in likelihood of trial modification cancellation
Loan had loan-to-value ratio greater than 140 percent, compared to 80 percent or less	-8%
Loan had loan-to-value ratio between 120 and 140 percent, compared to 80 percent or less	-7%
Borrower received principal forgiveness of between 1 and 50 percent of total loan balance	-6%
Borrower's principal and interest payment on loan reduced by more than 20 percent, compared to a decrease of 10 percent or less or an increase	-5%
Borrower's principal and interest payment on loan reduced by between 10 and 20 percent, compared to a decrease of 10 percent or less or an increase.	-5%
Borrower was 60 to 89 days days delinquent prior to trial modification, compared to being current on mortgage payments	6%
Borrower was 90 or more days delinquent prior to trial modification, compared to being current on mortgage payments	9%
Borrower was evaluated for trial modification based on stated income (prior to June 1, 2010)	52%
Borrower was in trial modification period for 4 months or less	58%

Source: GAO analysis of Treasury data.

In addition, our initial observations of over 15,000 non-GSE borrowers who had redefaulted from permanent HAMP modifications through

September 2010 indicated that these borrowers differed from those in active permanent modifications in several respects. Specifically, non-GSE borrowers who redefaulted on their HAMP permanent modifications tended to have the following characteristics

- higher levels of delinquency at the time of trial modification evaluation (median delinquency of 8 months compared to 5 months for those still in active permanent modifications);
- lower credit scores, although borrowers current on their HAMP-modified payments also had low median credit scores (525 and 552, respectively);
- lower median percentage of payment reduction compared with those who were still current in their permanent modifications (24 percent compared with 33 percent for those who were still current in their permanent modifications); and
- lower levels of debt before modification than borrowers who did not redefault (median front-end DTI ratio of 41 percent prior to modification compared to 46 percent front-end DTI ratio for those still current in their permanent modifications)—these borrowers likely did not receive as much of a payment reduction from the modification due to lower levels of debt to begin with.

These results were largely consistent with information that the Federal Deposit Insurance Corporation (FDIC) released on the performance of its IndyMac loan modifications. For example, FDIC found that borrowers' delinquency status prior to loan modification correlated directly with redefault rates after modification, with a 1-year redefault rate of roughly 25 percent for borrowers who were 2 months delinquent at the time of modification compared to a nearly 50 percent redefault rate for those who were more than 6 months delinquent at the time of modification.³¹ FDIC also reported that the redefault rates for its IndyMac modifications declined markedly with larger reductions in monthly payments.

³¹Richard Brown, *The FDIC Loan Modification Program at IndyMac Federal Savings Bank*. Presented at Mortgages and the Future of Housing Finance Conference, Washington, D.C., Oct. 25, 2010.

Some Key Information on HAMP Borrowers and Applicants Was Missing or Inaccurate in Treasury's Database

Treasury's data on HAMP provide important information and insights on characteristics of borrowers who are in trial and permanent modification, who have been canceled from trial modifications, and who have redefaulted from permanent modifications. However, Treasury's database contained information that was inaccurate or inconsistent, and Treasury does not collect information on all borrowers who are denied HAMP modifications. For example, Treasury's data on borrowers' LTV ratios at the time of modification ranged from 0 to 999, with 1 percent of non-GSE borrowers in active permanent modifications reporting ratios over 400 percent, implying that some borrowers who received HAMP modifications did not have a mortgage, and others had loan amounts more than 4 times the value of their homes. Some data elements also included internal inconsistencies. For example, a borrower's back-end DTI (the ratio of total monthly debt-to-gross monthly income) includes the front-end DTI (the ratio of monthly housing debt-to-gross monthly income) and, therefore, should always at least be equal to the front-end DTI. However, according to Treasury's database, 29 percent of those in trial modifications and 40 percent of those who had trial modifications canceled had back-end DTIs that were less than their front-end DTIs. The quality of these data improved for those who received permanent modifications, with only 3 percent of these borrowers showing back-end DTIs that were less than the front-end DTIs.

Treasury acknowledged that its HAMP database contained some inconsistencies, despite edit checks conducted by Fannie Mae as the HAMP administrator. According to Treasury, the inconsistencies continue because of servicers' data-entry errors, data formatting mistakes such as entering percentages as decimals rather than whole numbers, and data mapping problems. Treasury said it was continuing to work with Fannie Mae to refine and strengthen data quality checks and that the data has and will continue to improve over time. For example, Treasury noted that since September 2010, it has worked to improve the quality of borrower and loan attributes such as back-end DTI and modification terms. Treasury officials said that the error rate on these data elements has dropped from 16 percent and 12 percent for trial and permanent modifications, respectively, to 2 percent and 10 percent.

Treasury's HAMP database also was missing a significant amount of information on borrowers' race and ethnicity, resulting in an inability to date to assess whether HAMP is being fairly implemented across servicers. For example, as of September 30, 2010, race and ethnicity information was not available for 65 percent of non-GSE borrowers in active trial modifications. A significant portion of borrowers declined to report this

information—that is, for 45 percent of non-GSE borrowers in active trial modifications the category was marked as “not provided by borrower.” However, for another 20 percent, some data are simply missing, with no category marked. Some of this information may be missing because servicers were not required to report borrowers’ race and ethnicity until after December 1, 2009. As a result, Treasury lacks complete information needed to be able to determine whether the first-lien modification program has been implemented fairly across all borrowers.

In addition, Treasury acknowledged data-mapping problems with race and ethnicity data that resulted in some data being included in the system of record, but inadvertently excluded from the database. Combined, these factors resulted in a large proportion of borrowers without race and ethnicity information, as of September 30, 2010. According to Treasury officials, Fannie Mae was making improvements to the data mapping, which should allow Treasury to better evaluate whether HAMP is being implemented fairly across all borrowers. Treasury officials told us they anticipated that the more complete data would be ready to use in early 2011. On January 31, 2011, Treasury announced the availability of loan-level HAMP data to the public for the first time. The data files were as of November 30, 2010, and included information on borrowers’ race and ethnicity. According to Treasury, these data indicated that roughly 31 percent of borrowers who started trial modifications after December 1, 2009, did not report race and ethnicity data. Treasury also reported approximately 6 percent of data as not applicable or not reported by the servicer. In addition, roughly 57 percent of those who were denied or did not accept trial modifications did not report or were missing this information.

Finally, Treasury’s HAMP database did not contain information on all borrowers who were denied HAMP, as some borrowers were denied before income information was collected for a net present value test. Treasury currently requires servicers to report identifying information, such as borrowers’ names and Social Security numbers, as well as the reason for denial for all borrowers denied modification, but other data elements—including income information, level of delinquency, LTV, and GSE or non-GSE status—is not required to be collected by servicers if borrowers are denied because they do not meet basic eligibility requirements such as the property being owner-occupied. According to data we received from Treasury, through September 30, 2010, some information was lacking on 85 percent of borrowers who were denied HAMP trial modifications, including monthly gross income amounts and the number of months in delinquency. Treasury noted that these data are

incomplete because they are unobtainable by the servicers and not a good use of servicer resources to obtain. While we recognize that servicers may be unable to collect information from borrowers who were previously denied trial modifications, going forward it will be important for Treasury to collect sufficient information from servicers to assess program gaps. According to Treasury, it has requested servicers to report on borrowers who were denied HAMP when low volumes of these data were received.

Most Borrowers Denied or Canceled from Trial Modifications Appear to Have Avoided Foreclosure To Date, but Weaknesses in Treasury's Data Collection Limit its Ability to Understand the Outcomes of These Borrowers

Because there have been more HAMP trial modification cancellations than conversions to permanent modifications, we evaluated Treasury's reporting of the disposition paths, or outcomes, of borrowers who were denied or canceled from HAMP trial modifications and obtained additional information from six large MHA servicers to understand the extent to which these borrowers have been able to avoid foreclosure to date. While it appears that the majority of these borrowers had been able to avoid foreclosure as of the time of our data collection and Treasury's survey, if borrowers are being evaluated for a loss mitigation option such as a proprietary modification and the servicer has also started foreclosure proceedings, Treasury's data reporting template will result in a loan being reported only as a proprietary modification or the other applicable loss mitigation category, understating the number of borrowers who have had foreclosure proceedings started. In addition, Treasury's reporting of outcomes for these borrowers does not differentiate between borrowers who received proprietary modifications and those who were still being evaluated for these modifications, some of whom will not ultimately receive them. For example, for six large servicers, Treasury reported that 43 percent of borrowers who had their trial modification canceled received proprietary modifications.³² However, the reported 43 percent includes both borrowers who had received proprietary modifications and those who were being evaluated for proprietary modifications. Data we collected from the same servicers indicate that only 18 percent of borrowers with canceled trial modifications received permanent proprietary modifications, while another 23 percent had pending but not yet approved permanent modifications. Without a complete picture of the outcomes of those borrowers who were denied or canceled from HAMP, Treasury cannot accurately evaluate the outcomes for these borrowers

³²Treasury publicly reports these outcomes for the eight largest HAMP servicers, but we calculated the percentages for six of these servicers based on Treasury's report in order to compare them with the data we received from these same servicers.

and determine whether further action may be needed to assist this group of borrowers.

Treasury's Reporting Does Not Fully Reflect the Current Disposition Actions for Borrowers Denied or Canceled from HAMP

According to HAMP guidelines, servicers must consider all potentially HAMP-eligible borrowers for other loss mitigation options, such as proprietary modifications, payment plans, and short sales, prior to a foreclosure sale. To report the current outcomes of borrowers who applied for but did not receive a HAMP trial modification or had a HAMP trial modification canceled, Treasury surveys the eight largest HAMP servicers each month and publishes these data in the monthly servicer performance reports. However, Treasury's requirements for reporting these data produce results that do not fully reflect all outcomes for borrowers who were denied or canceled from HAMP and overstate the proportion of some outcomes. First, in order to prevent double counting of transactions, the survey does not allow servicers to place a borrower in more than one outcome category. Additionally, servicers must follow the order in which Treasury lists the outcomes on the survey. However, this does not allow for the accurate reporting of borrowers being considered for multiple potential outcomes. For example, a servicer could be evaluating a borrower who had been denied a HAMP modification for a proprietary modification at the same time that the servicer started foreclosure proceedings. But the Treasury survey would capture only the proprietary modification, because that category is the first in the list of possible outcomes. Because servicers are allowed to evaluate borrowers for loss mitigation options while simultaneously starting foreclosure, Treasury's requirement that borrowers be included in only one category, starting with proprietary modifications, likely overstates the proportion of borrowers with proprietary modifications while also understating the number of borrowers who have started foreclosure.

Furthermore, a comparison of Treasury's data to data we received from six large MHA servicers on the outcomes of borrowers denied a HAMP trial modification showed that Treasury's requirement that servicers place borrowers according to a specific order of outcomes may result in an understatement of the number of borrowers becoming current. For example, according to the data we received, almost 40 percent of borrowers who were denied a HAMP trial modification became current without any additional assistance from the servicer as of August 31, 2010. In comparison, Treasury reported only 24 percent of borrowers became current after applying for but not receiving a HAMP trial modification through these same servicers. While differences may exist between the populations of these data, a servicer we spoke with noted one reason that

the percentage of current borrowers in the Treasury survey was lower than the percentage reported in our data was Treasury's requirement that servicers report outcomes in a certain order, with "borrower current" being in last place.³³ As a result, borrowers are reviewed for all other outcomes before being reflected in this category. Placing borrowers only in one category according to a specific order may not reflect all of the outcomes experienced by these borrowers and may understate outcomes further down the list, such as starting foreclosure or becoming current.

Second, while Treasury's survey includes an "action pending" category, all six of the servicers we spoke with told us that Treasury had instructed them to include borrowers who were being evaluated for an outcome in their respective outcome categories, such as proprietary modification, rather than the "action pending" category. Treasury recently instructed servicers to use the action pending category only if a borrower had recently been denied a HAMP trial modification, had a HAMP trial modification canceled, or fallen out of another disposition path such as a proprietary modification, and the servicer has not yet determined the next step for the borrower. Because the proprietary modification category includes borrowers who are still being evaluated for modifications as well as those who have received them, the number of borrowers who actually received a proprietary modification cannot be determined from Treasury's data. For example, for the outcomes of borrowers who had a canceled HAMP trial modification, we asked six large MHA servicers to separate borrowers who were being evaluated for permanent proprietary modifications from those who had actually received them. For these same six servicers, while Treasury reported that 43 percent of borrowers who canceled from a HAMP trial modification through August 2010 were in the process of obtaining a proprietary modification, the data we received indicated that 18 percent of these borrowers had received permanent

³³Several differences exist between the populations of borrowers reported in our data and Treasury's report. First, our data included only borrowers who were denied a HAMP trial modification, while Treasury's also included borrowers who were offered but declined this option. Second, Treasury did not begin requiring servicers to report on borrowers who applied for but did not receive a HAMP trial modification until December 1, 2009, so some servicers did not have data on these borrowers until that date. Third, one servicer reported to us borrowers in a business division not reported in Treasury's survey, and another reported borrowers to Treasury for a business division not included in our report. Fourth, our data may reflect loans that have not yet been reported to Treasury due to differences in timing of reporting. Finally, Treasury defines "current" as being less than 60 days delinquent, while our "current" category includes borrowers who ranged from 0 to 30 days past due.

proprietary modifications, and 23 percent were in the process for being approved for one.³⁴ By including borrowers who received permanent proprietary modifications alongside borrowers who were still in the process for getting one, Treasury may not fully understand the extent to which servicers are providing permanent assistance to borrowers being denied or canceled from HAMP trial modifications.

While Treasury has taken steps to collect data on the outcomes of borrowers who do not receive a HAMP trial or permanent modification—data that could be used to assess the extent to which these borrowers are receiving other loss mitigation programs—the way in which Treasury has asked servicers to report these data overstates the proportion of certain outcomes and understates others, such as starting foreclosure proceedings. In addition, Treasury’s reporting does not differentiate between those who have received a proprietary modification and those who are being evaluated for one. If the information presented in the monthly servicer performance reports does not fully reflect the outcomes of these borrowers, Treasury and the public will not have a complete picture of their outcomes. Further, Treasury cannot determine the extent to which servicers provided alternative loss mitigation programs to borrowers denied or canceled from HAMP or evaluate the need for further action to assist this group of borrowers.

Outcomes of Borrowers Vary by Whether Borrowers were Denied, Canceled, or Redefaulted, and by Servicer

We requested data from six servicers on the outcomes of borrowers who (1) were denied a HAMP trial modification, (2) had a canceled HAMP trial modification, or (3) redefaulted from a HAMP permanent modification. According to the data we received, of the about 1.9 million GSE and non-GSE borrowers who were evaluated for a HAMP modification by these servicers as of August 31, 2010, 38 percent (713,038) had been denied a HAMP trial modification; 27 percent (505,606) had seen their HAMP trial modifications canceled; and 1 percent (20,561) had redefaulted from a HAMP permanent modification.³⁵ We requested that the servicers report all

³⁴We requested that servicers provide the data as of August 31, 2010, but servicers may report borrowers with a canceled HAMP trial modification to Treasury until early September 2010, for August 2010 reporting. In addition, servicers may have included loans in our data request that have not yet been reported to Treasury and, therefore, would not be reflected in the number of borrowers that Treasury reports. Lastly, one servicer reported borrowers to Treasury for a business division not included in our data.

³⁵Two servicers provided the data as of their closing date for reporting August 2010 data to Treasury, September 6, 2010, and September 8, 2010, respectively.

of the outcomes borrowers had received and they separate those who were being evaluated for an outcome from those who had received them.³⁶ According to the data we received, borrowers experienced different outcomes, depending on whether they were denied a HAMP trial modification, received but were canceled from a trial modification, or redefaulted from a permanent modification.

According to these servicers' data through August 31, 2010, borrowers who were denied HAMP trial modifications were more likely to become current on their mortgages without any additional help from the servicer (39 percent) than to have any other outcome (see fig. 5).³⁷ According to one servicer, borrowers who were denied a HAMP trial modification were often current when they applied for a HAMP modification and, once denied, were likely to remain current. In addition, 9 percent of these borrowers paid off their loans. Twenty-eight percent of borrowers who had been denied trial modifications received or were in the process for receiving a permanent proprietary modification or a payment plan.³⁸ Servicers initiated foreclosure proceedings on 17 percent at some point after being denied, while only 3 percent of borrowers completed foreclosure.³⁹ Several servicers explained that loss mitigation efforts can often work in tandem, so a borrower could be referred for foreclosure and evaluated for another outcome at the same time, and borrowers who were referred for foreclosure may not necessarily complete it.

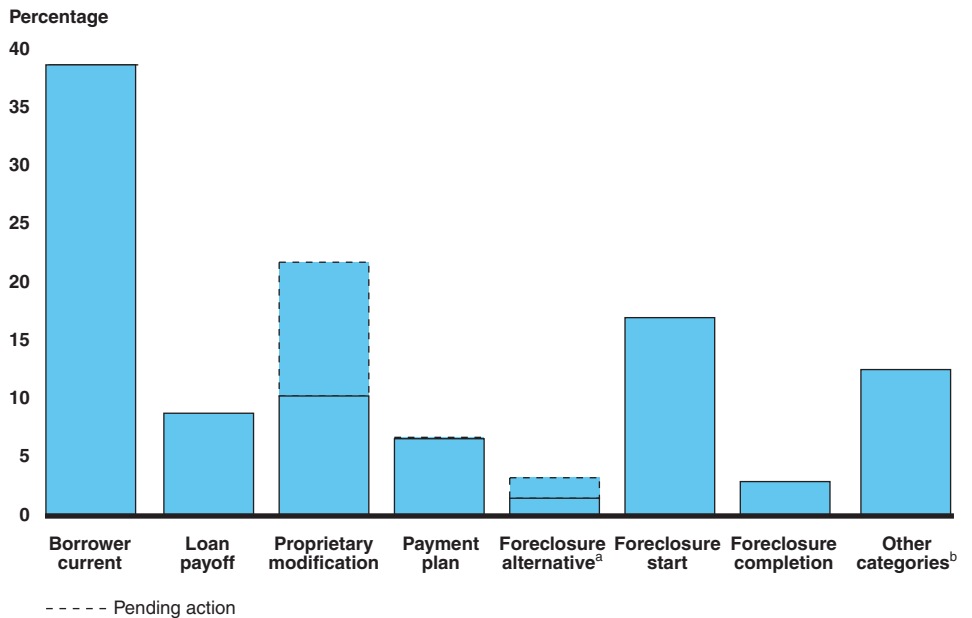
³⁶Because we requested that servicers report all outcomes that a borrower received, a borrower may be reflected more than one time across these outcomes. One servicer only provided the most recent outcome of these borrowers.

³⁷We requested that servicers provide the number of borrowers who were 0 days past due on their original loan without need for further loss mitigation efforts. Two servicers provided the number of borrowers who were 0 to 29 days delinquent, while another servicer provided the number of borrowers who were 0 to 30 days delinquent.

³⁸Three servicers were unable to provide the number of borrowers who had a payment plan pending because they only track payment plans once the payment plan has been set up or the borrower begins making payments.

³⁹We requested that servicers provide the number of borrowers who were referred for foreclosure at any time after redefaulting, having their modification canceled, or being denied.

Figure 5: Outcomes of Borrowers Denied a HAMP Trial Modification, through August 31, 2010 (Six large MHA servicers)



Source: GAO analysis of data received from six large MHA servicers.

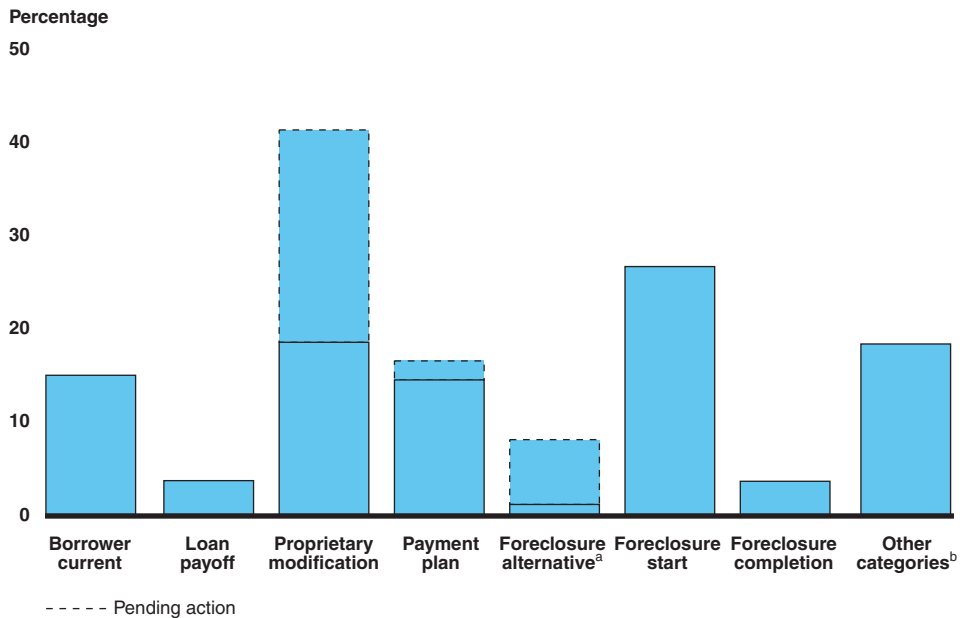
Note: Borrowers may be included in more than one category.

^aThe percentage of borrowers who received a foreclosure alternative may include borrowers who have a short-sale agreement signed but have not closed on the short sale.

^bOther categories include borrowers who had a bankruptcy in process and no other loss mitigation effort was allowed at some point after being denied, canceled, or redefaulting; borrowers who had action pending outside of a proprietary modification, payment plan, or foreclosure alternative; and borrowers not able to be reflected in any of the other outcomes, such as borrowers who currently have no workout plan in process.

Of those borrowers who were canceled from a HAMP trial modification, servicers often initiated actions that could result in the borrower retaining the home. Specifically, 41 percent of these borrowers received or were in the process for receiving a permanent proprietary modification, and 16 percent received or were in the process for receiving a payment plan (see fig. 6). However, servicers started foreclosure proceedings on 27 percent of borrowers at some point after the HAMP trial modification being canceled, but, similar to borrowers who were denied a HAMP trial modification during this time period, a small percentage completed foreclosure (4 percent). Compared with borrowers who were denied, borrowers who had a HAMP trial modification canceled were less likely to become current on their mortgages (15 percent) or to pay off their loan (4 percent).

Figure 6: Outcomes of Borrowers who Had a Canceled HAMP Trial Modification, through August 31, 2010 (Six large MHA servicers)



Source: GAO analysis of data received from six large MHA servicers.

Note: Borrowers may be included in more than one category.

^aThe percentage of borrowers who received a foreclosure alternative may include borrowers who have a short-sale agreement signed but have not closed on the short sale.

^bOther categories include borrowers who had a bankruptcy in process and no other loss mitigation effort was allowed at some point after being denied, canceled, or redefaulting; borrowers who had action pending outside of a proprietary modification, payment plan, or foreclosure alternative; and borrowers not able to be reflected in any of the other outcomes, such as borrowers who currently have no workout plan in process.

There were wide ranges in the outcomes among servicers we contacted for borrowers who were canceled from HAMP trial modifications (see table 1). For example, of those borrowers who had a canceled HAMP trial modification, one servicer reported that 26 percent had obtained a proprietary modification through August 31, 2010, compared with 14 percent for another servicer. In addition, for borrowers who had a canceled HAMP trial modification, one servicer reported foreclosure completion rates of almost 7 percent, while another servicer reported foreclosure completion rates of roughly 1 percent. Servicers reported a wide range of outcomes, which depend on factors such as the composition of loan portfolios and proprietary loss mitigation programs, including modifications, payment plans, and short sales. These programs can differ in design and may have, among other things, different eligibility requirements for borrowers.

Table 1: Selected Outcomes of Borrowers who Had a Canceled HAMP Trial Modification by Servicer, through August 31, 2010

	Proprietary modification	Payment plan	Current	Foreclosure alternative ^a	Foreclosure completion	Action pending		
						Proprietary modification	Payment plan	Foreclosure alternative
Servicer 1	24%	4%	12%	1%	5%	26%	N/A ^b	4%
Servicer 2	22	76	35	2	2	6	N/A	2
Servicer 3	26	1	3	1	7	24	N/A	2
Servicer 4	14	1	15	2	1	16	6%	14
Servicer 5	20	1	1	2	3	39	<1	6
Servicer 6	16	0	5	0	6	42	<1	4
Average (all servicers)	18%	14%	15%	1%	4%	23%	3%	7

Source: GAO analysis of data received from six large MHA servicers.

Note: This table does not reflect all outcomes that borrowers may have received, such as being referred for foreclosure or currently being reviewed for loss mitigation options. Borrowers may be included in more than one category.

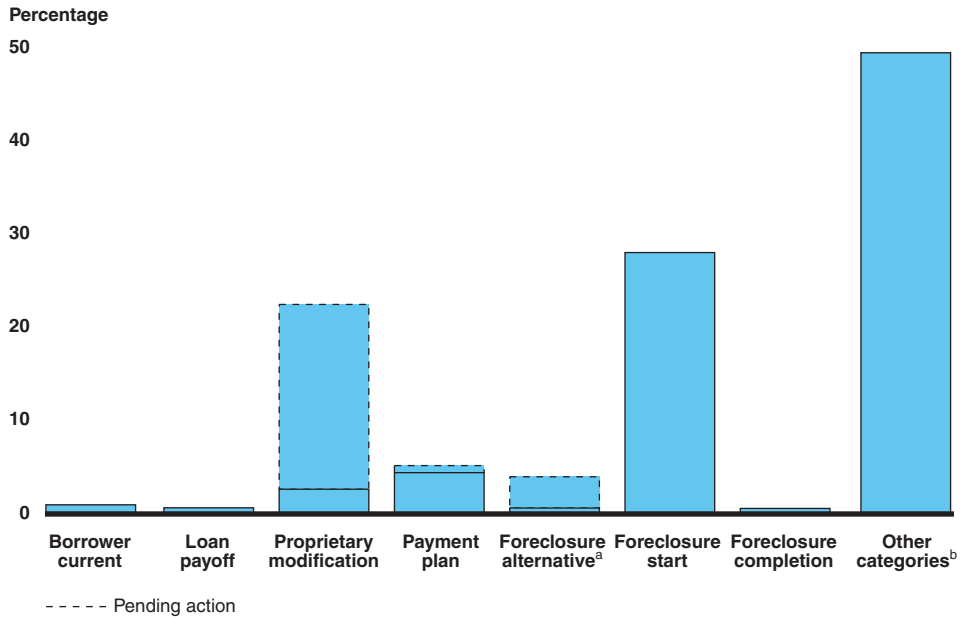
^aThe percentage of borrowers who received a foreclosure alternative may include borrowers who have a short-sale agreement signed but have not closed on the short sale.

^bN/A indicates servicer was unable to report this data.

Finally, of the borrowers who redefaulted from a HAMP permanent modification, almost half were reflected in categories other than proprietary modification, payment plan, becoming current, foreclosure alternative, foreclosure, or loan payoff (see fig. 7). Twenty-eight percent of borrowers who redefaulted from permanent modifications were referred for foreclosure at some point after redefaulting, but, like borrowers denied or canceled from a HAMP trial modification, the percentage of borrowers who completed foreclosure remained low relative to other outcomes (less than 1 percent). Unlike borrowers who were denied or canceled, borrowers who redefaulted were less likely to receive or be in the process for receiving a permanent proprietary modification or payment plan after redefaulting, with 27 percent of borrowers receiving or in the process for receiving one of the outcomes. In addition, less than 1 percent of borrowers who redefaulted became current as of August 31, 2010.⁴⁰

⁴⁰Because borrowers who redefault on a HAMP modification would still retain the terms of their HAMP modification, we would not expect many borrowers who redefaulted to receive a proprietary modification. One servicer, however, reported that 95 percent of those borrowers who redefaulted from a HAMP permanent modification had an action pending for a proprietary modification. The servicer explained that it evaluates the majority of these borrowers for another modification program after they redefault.

Figure 7: Outcomes of Borrowers Who Redefaulted on a HAMP Permanent Modification, through August 31, 2010 (Six large MHA servicers)



Source: GAO analysis of data received from six large MHA servicers.

Note: Borrowers may be included in more than one category.

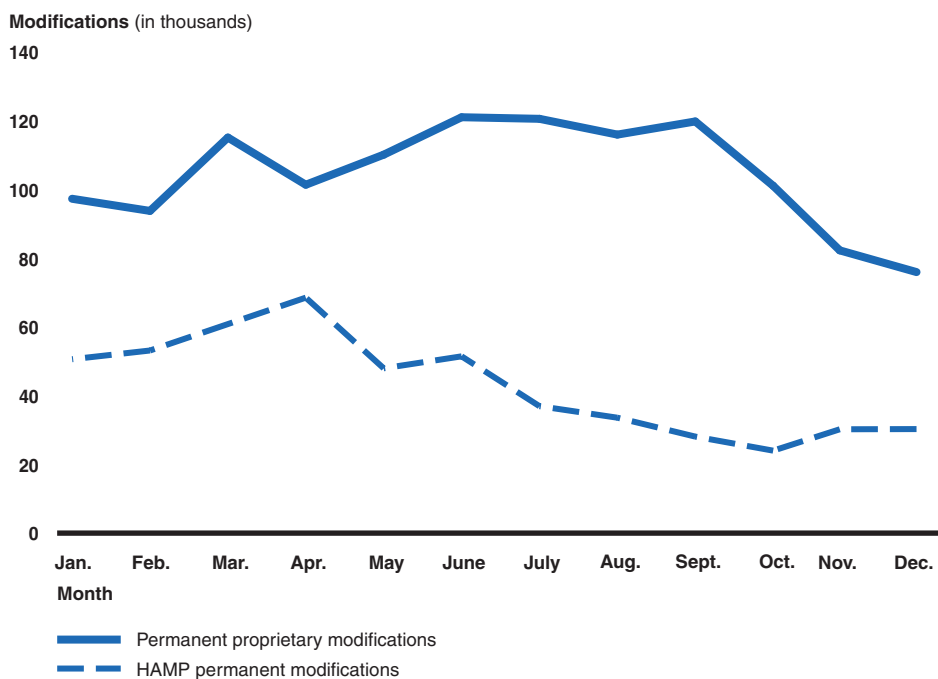
^aThe percentage of borrowers who received a foreclosure alternative may include borrowers who have a short-sale agreement signed but have not closed on the short sale.

^bOther categories include borrowers who had a bankruptcy in process and no other loss mitigation effort was allowed at some point after being denied, canceled, or redefaulting; borrowers who had action pending outside of a proprietary modification, payment plan, or foreclosure alternative; and borrowers not able to be reflected in any of the other outcomes, such as borrowers who currently have no workout plan in process.

Proprietary Modifications Offer Additional Flexibility and More Borrowers Have Received Them than HAMP Permanent Modifications

As noted above, servicers have reported that many borrowers who were denied, canceled, or redefaulted from HAMP have received or were being evaluated for proprietary modifications. According to HOPE NOW, servicers completed over 1.2 million proprietary modifications from January 2010 through December 2010, compared with roughly 513,000 permanent HAMP modifications (see fig. 8).⁴¹

Figure 8: Number of Proprietary and HAMP Modifications Started Each Month, January through December 2010



Sources: HOPE NOW for proprietary modifications and Treasury for HAMP modifications.

In designing the HAMP program, Treasury stated that it had to balance the needs of taxpayers, investors, and borrowers and develop a program that would ensure consistent and equitable treatment of borrowers by multiple servicers. In contrast, servicers told us they had greater flexibility with respect to the types of borrowers and conditions under which they could offer proprietary modifications. First, several servicers told us their

⁴¹HOPE NOW is an alliance between counselors, mortgage companies, investors, and other mortgage market participants. According to its December 2010 Industry Extrapolations and Metrics report, HOPE NOW estimates the survey covers 88 percent of the industry market.

proprietary modification programs had fewer documentation requirements. According to HAMP guidelines, borrowers must submit all required documentation in order to be evaluated for and offered a HAMP modification, including a Request for Modification and Affidavit, a tax form, documentation to support income, and a Dodd-Frank Certification form.⁴² While Treasury has taken steps to streamline documentation requirements in the past, both Treasury and servicers acknowledge that borrowers' failure to submit required documentation was one of the primary reasons for being denied or canceled from a HAMP trial modification. However, a servicer can offer a proprietary modification even if the borrower lacked all of the required documentation. For example, one servicer told us that if a borrower who was required to submit 10 documents for a proprietary modification submitted only 6, the servicer could still offer a modification if the 6 documents provided sufficient information.

Second, several servicers told us they were able to offer more proprietary modifications than HAMP modifications or help borrowers whom HAMP cannot, because their proprietary modifications had fewer eligibility requirements, such as restrictions on occupancy type. Treasury announced early on that the HAMP program was not designed to help all borrowers, such as those with investment properties and second homes. For a borrower to be eligible for a modification under HAMP, the property must be owner occupied, and according to Treasury's HAMP data, through September 2010, servicers have denied roughly 63,000 HAMP applicants (7 percent) who they said failed to meet this requirement.⁴³ But all six servicers who provided us with information offered proprietary modification programs without this restriction, allowing them to reach borrowers who were ineligible for HAMP. One servicer we spoke with noted that it had a large portfolio of investment properties that do not meet the eligibility requirements for a HAMP modification.

In addition, while HAMP guidelines require borrowers to have a front-end DTI above 31 percent, all of the servicers we spoke with indicated their proprietary modification programs also served borrowers who had front-

⁴²The Dodd-Frank Certification form certifies that the borrower has not been convicted of a financial felony, such as felony larceny, money laundering, or tax evasion, within the past 10 years.

⁴³Because Treasury does not report whether borrowers had GSE or non-GSE loans for all borrowers denied HAMP, this percentage includes both GSE and non-GSE HAMP denials.

end DTIs below 31 percent. The servicers explained that even with low DTIs many of these borrowers were still unable to make their mortgage payments because they had high levels of back-end debt, such as credit card balances and car loans. We previously reported that HAMP requires borrowers with high total household debt levels (postmodification DTI ratios greater than 55 percent) to agree to obtain counseling, but it does not require documentation that they actually received this counseling.⁴⁴ We continue to believe that it is important that Treasury determine whether borrowers are receiving this counseling and whether the counseling requirement is having its intended effect of limiting redefaults, as we recommended. When asked about the differences between effective proprietary modifications and HAMP modifications, roughly 63 percent of housing counselors who responded to this question on our Web-based survey ranked the ability of proprietary modifications to reach borrowers with DTIs less than 31 percent as one of the main differences. According to Treasury's HAMP data, through September 2010, roughly 215,000 borrowers (24 percent) who were denied HAMP were denied because they had a front-end DTI of less than 31 percent. Almost all of the servicers we received information from indicated that the eligibility requirements for their proprietary modification programs allowed mortgage balances that exceeded HAMP limits.⁴⁵ One servicer noted that the majority of its portfolio comprised super-jumbo loans, many of which fell outside the HAMP mortgage balance limits. Roughly 106,000 borrowers (12 percent) who were denied HAMP trial modifications through September 2010 were denied because of ineligible mortgages. Fifty-two percent of housing counselors also identified higher mortgage balance limits as another key difference between proprietary modifications and HAMP modifications.

Lastly, the servicers we received information from offered proprietary modifications with more flexible terms than HAMP modifications and could more easily be adapted to the circumstances of individual borrowers. HAMP guidelines require servicers to modify the terms of a mortgage through interest-rate reductions, term extensions, and other steps to bring the borrower's front-end DTI ratio down to 31 percent (see table 2). Several of the proprietary modification programs we reviewed had variable target housing ratios—with one going down to 24 percent—

⁴⁴GAO-09-837.

⁴⁵For a one-unit property, the unpaid principal balance limit to be eligible for the HAMP program is \$729,750; for a two-unit, \$934,200; for a three-unit, \$1,129,250; for a four-unit, \$1,403,400.

allowing servicers to bring a borrower’s payment down to a more affordable level for some borrowers. In addition, for a servicer to be required to offer a borrower a HAMP modification, HAMP requires the borrower to pass the NPV test with a front-end DTI ratio of 31 percent. However, some borrowers may fail the test at this level but would be able to pass with a higher DTI ratio—for example, at 38 percent. These borrowers may not be able to receive a HAMP modification, even though a DTI ratio of 38 percent may have been more affordable than their current mortgage payment. Some borrowers who are denied a HAMP modification due to a negative NPV result but have a positive NPV result with a higher front-end DTI may be offered a proprietary modification. For example, one servicer plans to use variable front-end DTI thresholds to bring borrowers’ DTI ratios into more affordable ranges. The servicer will calculate borrowers with front-end DTI ratios greater than 31 percent based on 31 percent, 35 percent, and 38 percent thresholds, and borrowers with front-end DTI ratios less than 31 percent could be brought down to a DTI as low as 24 percent if they pass the NPV test at this level. The servicer estimates that of 3,370 borrowers who were denied a HAMP trial modification because their front-end DTI was already below 31 percent or as a result of a negative NPV, 2,415 would pass the NPV test using the flexible front-end DTI ratio thresholds and could receive a proprietary modification.

Table 2: Terms of Selected Proprietary Modification Programs Compared to HAMP

	HAMP	Proprietary Modification Program 1	Proprietary Modification Program 2	Proprietary Modification Program 3	Proprietary Modification Program 4
Target DTI ratio	31%	None	31-42%	31-38%	24-38%
Interest rate floor	2%	2%	2%	1%	2%
Term extension	Up to 40 years	Up to 50 years	Up to 40 years	Up to 40 years	Up to 40 years
Principal forbearance	Yes	Yes	Yes	Yes	Yes
Principal forgiveness allowed	Yes	No	No	Yes	No
Duration of reduced interest rate until raised to cap ^a	5 years	Up to 5 years	3 years	Up to 5 years	5 years
Trial period	3 months	None	3 months	3 payments	3 months
Net spendable income per month limit	None	10%, or minimum of \$250, maximum of \$1,000	None	At least \$900 and \$200/dependent	None

Source: GAO analysis of documentation received from servicers.

^aAfter this length of time, the reduced interest rate under HAMP and each of these proprietary modification programs may step up, or incrementally increase, to a maximum interest rate.

In addition, having the flexibility to bring borrowers' front-end DTI ratios to below 31 percent allows servicers to account for borrowers' back-end DTI ratios when offering proprietary modifications. Several of the servicers we spoke with had proprietary modification programs that considered borrowers' overall affordability, or ability to pay, when modifying a mortgage, and the servicers calculated affordability differently. For example, one servicer addressed overall affordability by using a net spendable income calculation to determine a borrower's monthly mortgage payment. According to the servicer, its net spendable income calculation factors in all of the borrower's income and deducts all expenses, including credit cards and utility bills. This proprietary modification program was designed to leave the borrower with approximately 10 percent of net spendable income, with a minimum of \$250 and a maximum of \$1,000. Another servicer reported using family size to determine affordability. The servicer indicated that it calculated borrowers' monthly payments based on the nature of the borrowers' hardship, their current financial situation, and their change in circumstances, as well as a postmodification monthly net disposable income of \$600 and an additional \$100 per dependent. By incorporating family size, this proprietary modification program may be able to help some borrowers who may otherwise not qualify for HAMP.

Because servicers had a variety of proprietary modification programs that calculated affordability in a number of ways, and because their loan portfolios differed, the changes in mortgage terms as a result of proprietary modifications varied across servicers. According to data we received from six servicers, roughly 655,000 borrowers had permanent proprietary modifications as of August 31, 2010. These borrowers had their interest rate reduced by an average of 2.35 to 3.87 percentage points, depending on the servicer. In addition, the amount of term extension varied by each servicer. Specifically, servicers extended mortgage terms by an average of 87 to 178 months for borrowers who had permanent proprietary modifications. Lastly, servicers forbore varying amounts of principal, ranging from an average of \$33,971 to \$116,488, or 16 percent to 60 percent of the unpaid principal balance prior to modification.⁴⁶

⁴⁶One servicer was unable to report the amount of principal forbearance for roughly 99 percent of those borrowers who had proprietary modifications and, therefore, is not included in this range.

The Sustainability of Both HAMP and Proprietary Modifications Remain Unclear

While the number of proprietary modifications has outpaced the number of HAMP modifications, the sustainability of both types of modifications is still unclear. HAMP redefault rates have been relatively low to date, but it is likely too soon to draw conclusions about HAMP redefaults. While data on the redefault rates of HAMP and proprietary modifications are limited, the Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) reported that 11 percent of HAMP modifications and 22 percent of proprietary modifications that started in the fourth quarter of 2009 were 60 or more days delinquent after 6 months.⁴⁷ In addition, one servicer reported the redefault rates for its proprietary modifications were 26 percent at 6 months and roughly 40 percent at 12 months after the loan was modified, while another servicer reported redefault rates of 32 percent at 6 months and 51 percent at 12 months.

Proprietary modifications may not reduce monthly mortgage payments as much as HAMP modifications, potentially affecting the ability of borrowers to maintain their modified payments. According to OCC and OTS, during the third quarter of 2010, proprietary modifications reduced monthly mortgage payments by an average of \$332 per month, while HAMP modifications reduced them by an average of \$585 per month. According to our analysis of Treasury's HAMP data, borrowers who had a GSE or non-GSE HAMP permanent modification as of September 30, 2010, had their payments reduced by an average of \$632, or 33 percent of the average payment before modification. According to the data we received from six servicers, for GSE and non-GSE loans, borrowers with a permanent proprietary modification as of August 31, 2010, had their monthly mortgage payments reduced from an average of \$100 to \$691 per month, or 7 to 30 percent of the average monthly payment before modification. In response to our survey, housing counselors provided several examples of borrowers who had received proprietary modifications that did not substantially reduce monthly mortgage payments and that, in some cases, increased payments.

As we have seen, the extent to which modifications reduce monthly mortgage payments may correlate with the ability of borrowers to

⁴⁷The OCC and OTS publish a quarterly mortgage metrics report that includes data on first-lien residential mortgages serviced by national banks and thrifts, focusing on credit performance, loss-mitigation efforts, and foreclosures. OCC and OTS collect these data from the eight national banks and one thrift with the largest mortgage-servicing portfolios among national banks and thrifts. The data represent 64 percent of all first-lien residential mortgages outstanding in the country.

maintain modified payments. Specifically, OCC and OTS reported that modifications made in 2010 that reduced monthly mortgage payments by 20 percent or more resulted in a redefault rate of 12 percent 6 months after modification compared with 28 percent for modifications that reduced payments by 10 percent or less. However, servicers have told us their proprietary modification programs can serve borrowers with front-end DTIs below 31 percent—borrowers who would be ineligible for a HAMP modification. As a result, the average percentage monthly reduction for these borrowers may not be as high as it would be for those with a HAMP modification, because their premodification front-end DTI ratios were lower than those of borrowers who received a HAMP modification. Going forward, it will be important for Treasury to monitor redefault rates and understand how they differ across servicers and modification terms. We will also be looking at the redefault rates of HAMP and non-HAMP modifications, as well as the effectiveness of other foreclosure mitigation efforts, as part of our ongoing work looking at the broader federal response to the foreclosure crisis.

Conclusions

HAMP and the newer MHA programs were part of an unprecedented response to a particularly difficult time for our nation's mortgage markets. However, 2 years after Treasury first announced that it would use \$50 billion in TARP funds for various programs intended to preserve homeownership and protect home values, foreclosure rates remain at historically high levels. While Treasury originally estimated that 3 to 4 million people would be helped by these programs, only 550,000 borrowers had received permanent HAMP first-lien modifications as of November 30, 2010, and the number of borrowers starting trial modifications has been rapidly declining since October 2009. Moreover, Treasury has experienced challenges in implementing its other TARP-funded housing initiatives. In particular, the 2MP program, which Treasury has stated is needed to create a comprehensive solution for borrowers struggling to make their mortgage payments, has had a slow start. According to six large MHA servicers, they have faced difficulties—matching errors and omissions—in using the database required for identifying second liens eligible for modification under the program. As a result, servicers told us that relatively few second liens had been modified as of August 2010, a year after program guidelines were first issued. Treasury has taken some steps to address the issues that have slowed down implementation of the program, but more could be done to inform potentially eligible borrowers about 2MP. Specifically, borrowers whose second liens may be eligible for modification under 2MP may not be aware of the program or of any errors in the matching process, as servicers are

not required to inform borrowers receiving HAMP first-lien modifications that they could also be eligible for 2MP. Consequently, missed matches of first and second liens could go undetected, and some borrowers who were eligible for but not helped by the program are less able to keep up the payments on their first-lien HAMP modifications.

HAFAs and PRAs, two other key components of Treasury's TARP-funded homeownership preservation effort, have also had slow starts. In fact, servicers we spoke with did not expect HAFAs to increase the overall number of short sales performed, primarily due to extensive program requirements that lengthen the time frames associated with a short sale under the program. While Treasury has recently revised its HAFAs program requirements to allow servicers to bypass the HAMP first-lien program eligibility review for borrowers interested solely in participating in HAFAs and relaxed other HAFAs program requirements, it remains unclear the extent to which these changes will result in greater program participation. Additionally, because of the voluntary nature of the PRA program and concerns over the lack of program transparency, including the level of public reporting that will be available at the servicer level, it remains unclear how many borrowers will receive principal reductions under PRA. Treasury has stated that it will report on PRA activity when data are available, and we continue to believe that it will be important that this reporting includes the extent to which servicers determined that principal reduction was beneficial to investors but did not offer it, as we recommended in June 2010. If HAFAs and PRAs do not result in increased program participation, Treasury's efforts to combat the negative effects associated with avoidable foreclosures will be compromised, potentially limiting the ability of Treasury efforts to preserve homeownership and protect home values.

Further, Treasury could do more to apply lessons learned from its experience in implementing early HAMP programs to its more recent initiatives. We reported in June 2010 that the implementation of other TARP-funded homeownership preservation programs could benefit from lessons learned in the initial stages of HAMP implementation. Specifically, we noted that it would be important for Treasury to expeditiously develop and implement new programs while also developing sufficient program planning and implementation capacity, meaningful performance measures and remedies, and appropriate risk assessments in accordance with standards for effective program management. Already, 2MP, HAFAs, and PRAs have undergone several revisions, and servicers cited changing guidelines and short implementation periods as significant challenges in fully implementing the programs. In July 2009, we recommended that

Treasury place a high priority on fully staffing vacancies in the Homeownership Preservation Office (HPO) and evaluating staffing levels and competencies. As of January 2011, Treasury has filled key positions in HPO, but has not conducted a formal assessment of its staffing levels despite the implementation of the newer programs. We continue to believe that it is essential that Treasury ensure that it has enough staff with the appropriate skills to govern TARP-funded housing programs effectively. While Treasury has conducted reviews of the readiness of servicers participating in 2MP, HAFA, and PRA to successfully implement the programs, a large majority of servicers did not provide all documentation required to demonstrate that the key tasks needed to support these programs were in place. It is imperative that Treasury take swift action to ensure that servicers have the ability to implement these programs since, as we have seen with the slow progress of the HAMP first-lien modification program, the success of these TARP-funded initiatives will be largely driven by the capacity and willingness of servicers to implement these programs in an expeditious and effective manner. In addition, Treasury has not developed program-specific performance measures against which to measure these programs' success and has not specified the remedies it will take if servicers are not meeting performance standards. Without specific program measures and remedies, Treasury will not be able to effectively assess the outcomes of these programs and hold servicers accountable for performance goals. We continue to believe that it is important for Treasury to develop such performance measures and clear goals for them, as we have recommended.

Treasury requires servicers to submit data on borrowers who have been evaluated for HAMP, and these data provide important information and insights on the characteristics of borrowers who are in trial and permanent HAMP modifications, who have been canceled from trial modifications, and who have redefaulted from permanent modifications. However, Treasury's HAMP database also contains inaccurate or missing information on certain key variables, including LTV ratios and borrowers' race and ethnicity. Treasury has stated that it is working to improve the quality of its data, and it will be important that the agency do so expeditiously. Complete and accurate information is important for Treasury to fully understand the characteristics of borrowers who HAMP has been unable to help or determine program compliance. Moreover, this information is important to identify what additional steps or adjustments that could be made to existing TARP-funded programs to better achieve the mandated goals of preserving homeownership and protecting property values.

Finally, while Treasury has begun publicly reporting the outcomes for borrowers who have been denied or canceled from HAMP trial modifications, its reporting practices make it difficult to determine the extent to which these borrowers are helped by non-HAMP (proprietary) loan modifications. For example, data we collected from six large MHA servicers showed that only 18 percent of borrowers canceled from a HAMP trial modification had received a proprietary modification and an additional 23 percent had a proprietary modification pending. However, Treasury reported that 43 percent of these borrowers were in the process of receiving a proprietary modification with those same six servicers. Furthermore, Treasury's system for reporting outcomes requires servicers to place borrowers in only one category even when borrowers are being evaluated for several possible outcomes, with proprietary modifications reported first. As a result, the proportion of borrowers with proprietary modifications is likely overstated relative to other possible outcomes, such as foreclosure starts. Without accurate reporting of borrower outcomes, Treasury cannot know the actual extent to which borrowers who are denied, canceled, or redefaulted from HAMP are helped by other programs or evaluate the need for further action to assist this group of homeowners.

Recommendations for Executive Action

As part of its efforts to continue improving the transparency and accountability of MHA, we recommend that the Secretary of the Treasury take actions to

- require servicers to advise borrowers to notify their second-lien servicers once a first lien has been modified under HAMP to reduce the risk that borrowers with modified first liens are not captured in the LPS matching database and, therefore, are not offered second-lien modifications;
- ensure that servicers demonstrate they have the operational capacity and infrastructure in place to successfully implement the requirements of the 2MP, HAFA, and PRA programs; and
- consider methods for better capturing outcomes for borrowers who are denied, canceled, or redefaulted from HAMP, including more accurately reflecting what actions are completed or pending and allowing for the reporting of multiple concurrent outcomes, in order to determine whether borrowers are receiving effective assistance outside of HAMP and whether additional actions may be needed to assist them.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for its review and comment, and we received written comments from the Acting Assistant Secretary for Financial Stability that are reprinted in appendix III. We also received technical comments from Treasury that we incorporated into the report as appropriate. In its written comments, Treasury stated that it appreciated our efforts in assessing the housing programs initiated under its TARP program and acknowledged the draft report's description of the operational capacity and infrastructure challenges faced by servicers in implementing Treasury's housing programs. In addition, Treasury noted that our research in proprietary modifications made by servicers outside of MHA was useful. However, Treasury stated that it believed that the draft report raised certain criticisms regarding the design and implementation of MHA that were unwarranted.

First, Treasury stated that the draft report criticized Treasury for the number of changes made to its housing programs following their implementation, and its alleged failure to incorporate the lessons it learned from the first-lien HAMP program into the roll out and design of other MHA programs, such as HAFA. Treasury stated that the report should acknowledge the circumstances under which the programs were first implemented. In response, we added some additional language recognizing that HAMP and the newer MHA programs were part of an unprecedented response to a particularly difficult time for our nation's mortgage markets. However, servicers we spoke with noted that ongoing changes to guidelines have presented challenges such as needing to update internal servicing systems and retrain staff which, in some cases, delayed program implementation. In addition, as noted in the draft report, Treasury has repeated some of the practices that were the focus of previous recommendations we had made for the first-lien program in its implementation of its newer MHA programs. For example, in our July 2009 report, we found that Treasury had not developed a means of systematically assessing servicers' capacity to meet program requirements during program admission, and we recommended further action in this area to increase the likelihood of success of the program. In our review of the newer MHA programs, we also found that Treasury had not fully ensured that servicers had the capacity to successfully implement these programs. We continue to believe that such action is needed to better ensure the likelihood of success of these newer MHA programs.

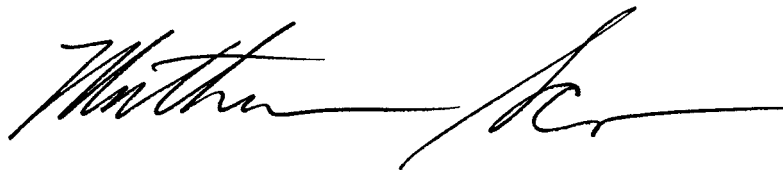
Second, Treasury raised concerns about the draft report's comparison of HAMP modifications to proprietary modifications. Treasury noted that it did not believe that it was constructive to assess HAMP's performance based on the goals of proprietary programs that are not government

supported. We have added some additional language to the report to provide additional context to the report's discussion of proprietary modifications. The purpose of this report was not to assess the performance of HAMP modifications based on the goals of proprietary modifications. Instead, the draft report provided a description of proprietary modifications and some of the ways that they differ from HAMP modifications. It does not suggest that the objective of HAMP modifications and proprietary modifications are or should be the same, particularly given Treasury's responsibility to safeguard taxpayer dollars under HAMP. As noted by Treasury in its comment letter, there is little available information about these proprietary modifications, and the more that is known about their terms and outcomes, the easier it will be for policymakers and regulators to craft appropriate changes to MHA and other housing programs aimed at preventing avoidable foreclosures.

Third, Treasury noted that the draft report criticized the completeness and quality of the data collected by Treasury related to HAMP modifications, and that it disagreed with the conclusion that missing or inaccurate information limits Treasury's ability to identify program gaps. Treasury noted that it relies on data provided by the borrowers to the servicers and it has improved significantly over the past 6 months, especially as the program moved to verified income. Treasury stated that the data on permanent modifications is robust, allowing Treasury to determine gaps in programs and how to make improvements. In the draft report, we acknowledged that Treasury is working with Fannie Mae to improve the data and, particularly with borrower race and ethnicity information, the data has improved over time. However, it is equally important that Treasury obtain complete and accurate information on those who are denied or canceled from a HAMP trial modification. Without such information, Treasury cannot determine if servicers are implementing the program fairly or whether additional actions may be necessary to address the needs of borrowers who are denied or canceled from HAMP trial modification. Going forward, it will be important for Treasury to continue to improve the quality of its HAMP data as this information is important to identify what additional steps or adjustments could be made to existing TARP-funded housing programs to better achieve the mandated goals of preserving homeownership and protecting property values.

We are sending copies of this report to interested congressional committees and members of the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, Treasury, the federal banking regulators, and others. This report is also available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-8678 or sciremj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink, appearing to read "Mathew J. Scire". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Mathew J. Scire
Director
Financial Markets and
Community Investment

List of Congressional Committees

The Honorable Daniel K. Inouye
Chairman

The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Tim Johnson
Chairman

The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman

The Honorable Jeff Sessions
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
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The Honorable Orrin G. Hatch
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Committee on Finance
United States Senate

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The Honorable Norman D. Dicks
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable Paul Ryan
Chairman

The Honorable Chris Van Hollen
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Dave Camp
Chairman
The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Scope and Methodology

To examine the status of the Department of Treasury's (Treasury) second-lien modification, principal reduction, and foreclosure alternatives programs and the design and implementation challenges Treasury and servicers have faced with these programs to date, we spoke with and obtained information from six large Making Homes Affordable (MHA) servicers, including the four largest servicers participating in the Second-Lien Modification Program (2MP) at the start of our review. These six servicers were: American Home Mortgage Servicing, Inc.; Bank of America; CitiMortgage; JP Morgan Chase Bank; OneWest Bank; and Wells Fargo Bank. We determined these as six large MHA servicers based on the amount of Troubled Asset Relief Program (TARP) funds they were allocated for loan modification programs. These six servicers collectively represented 72 percent of the TARP funds allocated to participating servicers. For each of these six servicers, we reviewed their 2MP, Home Affordable Foreclosure Alternatives (HAFA), and the Principal Reduction Alternatives (PRA) guidance, policies, procedures, process flows, training materials, and risk assessments, as applicable; and interviewed management staff. We also reviewed 2MP, HAFA, and PRA documentation issued by Treasury, including the supplemental directives related to 2MP, HAFA, and PRA, readiness assessments of servicers, and reporting process flows. We also spoke with officials at Treasury to understand the challenges faced in implementing these programs and the steps taken by Treasury to assess the capacity needs and risks of these programs, as well as steps taken to measure the programs' success. We spoke with trade associations representing investors, mortgage insurers, servicers, and an organization representing homeowners and community advocates. Finally, we reviewed the *Standards for Internal Control in the Federal Government* to determine the key elements needed to ensure program stability and adequate program management.

To examine the characteristics of homeowners who the Home Affordable Modification Program (HAMP) has been able to help, we obtained and analyzed Treasury's HAMP data in its system of record, Investor Reporting/2 (IR/2), through September 30, 2010. We reviewed Treasury guidelines on reporting requirements for HAMP, including the information servicers are required to report for borrowers who were denied trial modifications, and spoke with Treasury and Fannie Mae officials to understand potential inconsistencies and gaps in the data. We determined that the data was sufficiently reliable for our purposes. We also used the data to perform an econometric analysis of factors that contribute to borrowers' likelihood of seeing their trial modifications canceled (see appendix II for more details). We received and incorporated feedback on our model from Treasury and others. To obtain housing counselors' views

of borrowers' experiences with HAMP, we conducted a Web-based survey of housing counselors who received funding from NeighborWorks America, a national nonprofit organization created by Congress to provide foreclosure prevention and other community revitalization assistance to the more than 230 community-based organizations in its network. We received complete responses from 396 counselors. This report does not contain all the results from the survey. The survey and a more complete tabulation of the results will be part of an upcoming report.

Finally, to examine the outcomes for borrowers who were denied or fell out of HAMP trial or permanent modifications, we reviewed HAMP program documentation on policies for evaluating these borrowers for other loss mitigation programs. We reviewed the outcomes of borrowers who applied for but did not receive a HAMP trial modification or who had a canceled HAMP trial modification as reported by Treasury in the monthly MHA servicer performance reports. We obtained documentation from Treasury and interviewed servicers to understand how Treasury collects data on the outcomes of these borrowers. In addition, we obtained data from the six large MHA servicers noted earlier in this appendix. Specifically, we obtained and analyzed data on the outcomes of all borrowers who were denied a HAMP trial modification, had a canceled HAMP trial modification, or redefaulted on a HAMP permanent modification; the number of proprietary modifications completed; and the characteristics of the terms of these proprietary modifications. The servicers provided the data between when they began participating in the HAMP program and August 31, 2010, or the date in which they submitted their August 2010 reporting to Treasury (e.g., September 6, 2010).¹ According to the data we received, the number of trial modifications offered by these six servicers represented 72 percent of the total number of trial modifications offered by all servicers as reported by Treasury through September 2, 2010. We determined that these data were reliable for the purposes of our report. To understand why servicers may offer more proprietary modifications than HAMP modifications, we reviewed data on the number of completed proprietary modifications published by HOPE NOW, an alliance between counselors, mortgage companies, investors, and other mortgage market participants. In addition, we

¹Treasury did not require servicers to report data on borrowers who were denied a HAMP trial modification until December 1, 2009. As a result, three of the six servicers provided the outcomes of borrowers who were denied a HAMP trial modification from December 1, 2009, through August 31, 2010, or the date they submitted their August 2010 reporting to Treasury.

reviewed documentation on the terms and eligibility requirements of the proprietary modification programs offered by the six servicers participating in our review. In addition, we interviewed these servicers about the features of their proprietary modification programs. Also, through our Web-based survey of housing counselors, we received responses on the differences between effective proprietary modifications and HAMP modifications, as well as examples of effective and ineffective proprietary modifications. Finally, to understand the sustainability of HAMP and proprietary modifications, we reviewed data published by the Office of the Comptroller of the Currency and the Office of Thrift Supervision on the redefault rates and monthly payment reduction of HAMP modifications, as well as data we collected from servicers on the redefault rates, terms, and monthly payment reductions of their GSE and non-GSE proprietary modifications.

We conducted this performance audit from July 2010 through March 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

Appendix II: Description of GAO's Econometric Analysis of HAMP Trial Loans Modifications Cancellations

Data and Model Specification

To describe the characteristics of the borrowers and mortgages that have been canceled from the trial modification, we used an econometric analysis rather than present descriptive statistics since it allowed us to control for the impacts of potential confounding factors, including differences across servicers as well as default-risk differences among the borrowers that are not observable (unobserved borrower heterogeneity).¹ Servicers who participate in the Home Affordable Modification Program (HAMP) are required to provide periodic loan level data to Fannie Mae in its capacity as the administrator for the HAMP program. Specifically, servicers are required to report data at the start of the trial modification period and during the modification trial period, for loan set up of the approved modification, and monthly after the modification is set up on Fannie Mae's system. The data used in our econometric analysis are for HAMP loans as of September 30, 2010.² The data have one record per loan, with information on the loan status—whether the loan is denied for trial modification, has entered the trial plan, and its outcome (i.e., converted to the permanent modification, or still active in the trial plan, or has fallen out). We excluded loans that entered the trial plan from July 2010 through September 2010 (which is the end of the current data set) because not enough time had likely elapsed for loans in this pool to have defaulted or been canceled.

Through September 30, 2010, several servicers have signed up for HAMP. Seventeen of them, we categorized as “large” based on the Treasury reported data on “estimated eligible loans 60 days or more delinquent,” have over 90 percent of the loans—the remainder of the servicers were grouped into the “other” category.³ For the universe of 1,361,832 loans that had entered the trial period plan as of September 30, 2010, the average cancellation rate was 50 percent. The sample we used for the regression analysis, based on data availability, consists of 727,095 loans (53 percent of the universe), with an average cancellation rate of 50 percent. The sample data exclude servicers whose share of loans or fallout rates for the sample differed a lot from that of the universe; there are 13 “large” and “other” servicers.

¹The econometric methodology and findings were reviewed by Professor Anthony Pennington-Cross, Marquette University, Marquette, Wis., and Professor Hashem Dezhbakhsh, Emory University, Atlanta, Ga.

²The data used for the analysis were restricted to one-unit single family, principal residence, owner-occupied housings located in the 50 states of the United States and the District of Columbia.

³Treasury, *Making Home Affordable Program: Servicer Performance Report Through September 2010* (Washington, D.C., October 2010).

**Appendix II: Description of GAO's
Econometric Analysis of HAMP Trial Loans
Modifications Cancellations**

Following the literature, we used a reduced-form probability model to help determine the effects of the characteristics of the borrower and mortgage on HAMP trial loan cancellations. Accordingly, based on economic reasoning, data availability, the HAMP guidelines, and previous studies on loan performance, we use probabilistic models to estimate the likelihood that a loan modified under the trial period plan does not convert to a permanent modification. The dependent variable for the cancellations is binary, which equals 1 if a loan that entered the trial-period plan did not convert to permanent modification and 0 otherwise. The explanatory variables that we include in the model are conditioned by the available data (see table 3 for the list of the variables).

Table 3: Summary Statistics of Variables Used in Regressio

If trial modification canceled	Mean	Median	Standard Deviation	Minimum	Maximum
Months since loan origination ^a	0.1246	0	0.5000	0	1
If credit score >=620	0.1205	29	20	0	396
If back-end DTI >=55	0.2263	0	0.4586	0	1
Back-end DTI flag ^b	0.2352	1	0.4776	0	1
If mark-to-market LTV (MLTV) <= 80%	0.1439	0	0.3302	0	1
If MLTV between 80 & 100%	0.2741	0	0.3255	0	1
If MLTV between 100 & 120%	0.0144	0	0.4184	0	1
If MLTV between 120 & 140%	0.1627	0	0.4241	0	1
If MLTV >140%	0.0988	0	0.3510	0	1
MLTV flag ^c	0.1056	0	0.4461	0	1
If borrower's payments are current	0.6298	0	0.1190	0	1
If 30 days delinquent	0.8567	0	0.3691	0	1
If 60 days delinquent	0.2107	0	0.2984	0	1
If 90 days or more delinquent	0.6196	0	0.3073	0	1
If trial length <= 4 months	0.0004	1	0.4829	0	1
If original loan had private mortgage insurance	0.1021	1	0.3504	0	1
If fixed rate at origination vs nonfixed	0.1280	0	0.4078	0	1
If no decrease in principal and interest (P&I) payment	0.7694	1	0.4855	0	1
If no decrease in principal and interest (P&I) payment	0.0155	0	0.0210	0	1
If P&I decreased between 0 & 10%	0.2131	0	0.3029	0	1
If P&I decreased between 10 & 20%	0.3353	0	0.3341	0	1
If P&I decreased more than 20%	0.1160	1	0.4212	0	1
If principal reduction between 1 & 50%	0.8851	0	0.1235	0	1
If principal forbearance between 1 & 50%		0	0.4095	0	1
If private loan vs. GSE loan		0	0.4721	0	1
If portfolio loan vs GSE loan		0	0.3202	0	1
If stated income vs. verified income ^d			1		

Source: GAO Analysis of Treasury data.

**Appendix II: Description of GAO's
Econometric Analysis of HAMP Trial Loans
Modifications Cancellations**

Note: The total number of observations used for regression analysis is 727,095 loans.

^aThe months since origination is the difference between origination date and January 1, 2009. A condition for loan-modification eligibility is that the loan was originated between January 1, 1959 and January 1, 2009.

^bThe back-end debt-to-income (DTI) ratio after modification was replaced with the back-end DTI before modification if the former was missing; this affected about 12% of the data (back-end DTI flag). The regression estimates were similar when the flag was excluded.

^cThe MLTV ratio was replaced with the loan-to-value (LTV) at origination if the former was missing—this affected about 1% of the data (MLTV flag). The regression estimates were similar when the flag was excluded.

^dFor servicers who allowed borrowers to submit applications with stated incomes prior to June 1, 2010.

We estimated cancellation rates using binomial logistic probability (logit) models, an approach commonly used in economics to examine choices and evaluate various events or outcomes.⁴ The models included fixed effects for the servicers, which allowed us to account for both the observed and unobserved characteristics of the servicers.⁵ We also included state-level fixed effects to control for factors that vary across the states but are the same within a state, such as the type of foreclosure laws and other state policies on mortgages.

Econometric Results

The basic regression results from using the probability model, described above and the data in table 3, are presented in table 4. Most of the variables were statistically significant at the 5 percent level or better, and typically consistent with our expectations as to the direction of their impacts. We discuss below the key findings, based on statistically (and

⁴We note that this approach is appropriate since we are primarily interested in the probability that a trial loan falls out and not the hazard rate of the fallout (i.e., the probability that a trial loan falls out at a certain time if it has not already fallen out up to that time). Furthermore, the available data do not permit us to analyze the latter situation.

⁵Since the servicers have more than one loan in HAMP, the fixed effects allow us to adjust the standard errors for dependence among those loans, and also control for all stable characteristics of the servicers, whether observed or unobserved. The fixed effects technique uses the variation within the servicers to estimate the coefficients.

**Appendix II: Description of GAO's
Econometric Analysis of HAMP Trial Loans
Modifications Cancellations**

economically⁶⁾ significant changes in the likelihood of cancellation, using the estimated marginal effects of the explanatory variables.⁷

Table 4: Probabilistic Estimates of HAMP Trial Loan Modification Cancellation Rates

Variable	Marg. effect	Estimate	Standard error	Pr >ChiSq	Odds ratio
Intercept	-1.2516	-8.0280	0.1383	<.0001	0.000
Months since origination	0.0006	0.00375	0.000171	<.0001	1.004
If credit score >= 620	0.0066	0.0426	0.00717	<.0001	1.044
If back-end DTI >= 55%	-0.0229	-0.1468	0.00711	<.0001	0.863
Back-end DTI flag	0.5749	3.6875	0.0176	<.0001	39.946
If MLTV between 80 & 100% vs. MLTV <= 80%	0.0071	0.0458	0.0114	<.0001	1.047
If MLTV between 100 & 120% vs. MLTV <= 80%	-0.0261	-0.1675	0.0118	<.0001	0.846
If MLTV between 120 and 140% vs. MLTV <= 80%	-0.0673	-0.4318	0.0131	<.0001	0.649
If MLTV >140 vs. MLTV <= 80%	-0.0765	-0.4906	0.0126	<.0001	0.612
MLTV flag	-0.1129	-0.7242	0.0319	<.0001	0.485
If 30 days delinquent vs. current	0.0043	0.0274	0.0129	0.0339	1.028
If 60 days delinquent vs. current	0.0626	0.4017	0.0120	<.0001	1.494
If 90 days or more delinquent vs. current	0.0921	0.5909	0.00914	<.0001	1.806
If trial length <= 4 months	0.5803	3.7218	0.0166	<.0001	41.340
If original loan had PMI	0.0100	0.0640	0.00804	<.0001	1.066
If original loan had fixed rate	0.0046	0.0294	0.00715	<.0001	1.030
If payment decrease between 10 & 20% vs. <= 10%	-0.0539	-0.3460	0.0126	<.0001	0.708
If payment decrease > 20% vs. <= 10%	-0.0543	-0.3481	0.0104	<.0001	0.706
If principal reduction between 1 & 50%	-0.0564	-0.3617	0.0416	<.0001	0.696
If principal forbearance between 1% & 50%	-0.0298	-0.1912	0.00766	<.0001	0.826
If private loan vs. GSE loan	0.0406	0.2607	0.00850	<.0001	1.298
If portfolio loan vs. GSE loan	-0.0546	-0.3501	0.0115	<.0001	0.705
If stated income vs verified income	0.5189	3.3285	0.0619	<.0001	27.896
Servicer 1 vs. other servicers	-0.1772	-1.1363	0.0746	<.0001	0.321
Servicer 2 vs. other servicers	0.1979	1.2691	0.0206	<.0001	3.558
Servicer 3 vs. other servicers	0.2263	1.4516	0.0121	<.0001	4.270
Servicer 4 vs. other servicers	0.0350	0.2242	0.0152	<.0001	1.251
Servicer 5 vs. other servicers	0.4284	2.7479	0.0653	<.0001	15.609
Servicer 6 vs. other servicers	0.3010	1.9305	0.0196	<.0001	6.893
Servicer 7 vs. other servicers	0.4173	2.6766	0.0654	<.0001	14.535
Servicer 8 vs. other servicers	0.1130	0.7245	0.0188	<.0001	2.064

⁶An economically significant result implies the impact is large and meaningful. We use a threshold of 5 percent marginal effect.

⁷The odds ratios of the estimates are also reported. An odds ratio close to one means the variable is neither more nor less likely to influence fallouts. Deviations from one indicate the direction and strength of the effects. An odds ratio greater than one means the factor is more likely to impact fallouts; similarly, an odds ratio less than one means the factor is less likely to impact fallouts.

**Appendix II: Description of GAO's
Econometric Analysis of HAMP Trial Loans
Modifications Cancellations**

Variable	Marg. effect	Estimate	Standard error	Pr >ChiSq	Odds ratio
Servicer 9 vs. other servicers	0.3404	2.1834	0.0202	<.0001	8.876
Servicer 10 vs. other servicers	0.0835	0.5358	0.0194	<.0001	1.709
Servicer 11 vs. other servicers	0.4570	2.9311	0.0712	<.0001	18.748
Servicer 12 vs. other servicers	0.0900	0.5770	0.0873	<.0001	1.781
Servicer 13 vs. other servicers	0.2669	1.7121	0.0136	<.0001	5.540

Source: GAO Analysis of Treasury data.

Note: Likelihood Ratio Test: Chi-square = 326594, df = 81, Prob Chi-Square < 0.0001. Area under Receiver Operating Characteristic (ROC) curve, c-statistics = 0.854. Pseudo R-square = 0.3618, Max-rescaled R-square = 0.4825. The estimates for the states are not reported.

- *Stated income.* Loans that entered the trial plan using stated income documentation were 52 percent more likely to be canceled, compared to verified income.⁸ This effect was consistent with expectations since these borrowers are likely not to be able to provide verified documentation when requested.
- *Trial length.* Trial periods that last for 4 months or less were about 58 percent more likely to be canceled compared to those that stay in the trial plan for a longer term. A longer stay in the trial plan implies the borrower's payments are current and, therefore, less likely to be canceled. This result is generally consistent with the hazard models of mortgage performance that indicate that loans that are likely to default do so much earlier than later.
- *Delinquency status.* Borrowers who were 60 days or 90 days or more past due on their mortgages before the trial-period plan, compared to borrowers who were current, were 6 and 9 percent more likely to have their loans canceled, respectively; thus, the longer the delinquency status the more likely the cancellation. This effect is consistent with expectations.
- *Payment Reduction.* The reduction in payment generally results from interest rate reduction and extension of the loan term. Loans that receive reductions in payments (of principal and interest) of more than 10 percent, compared to reductions that are less than 10 percent or less (which include no reductions and increases in payments), were 5 percent less likely to be canceled. This result is expected since the payment reductions increase the affordability of the mortgage, a key objective of HAMP.

⁸These are for loans where, prior to June 1, 2010, a servicer allowed borrowers to provide stated income documentation to start the trial plan.

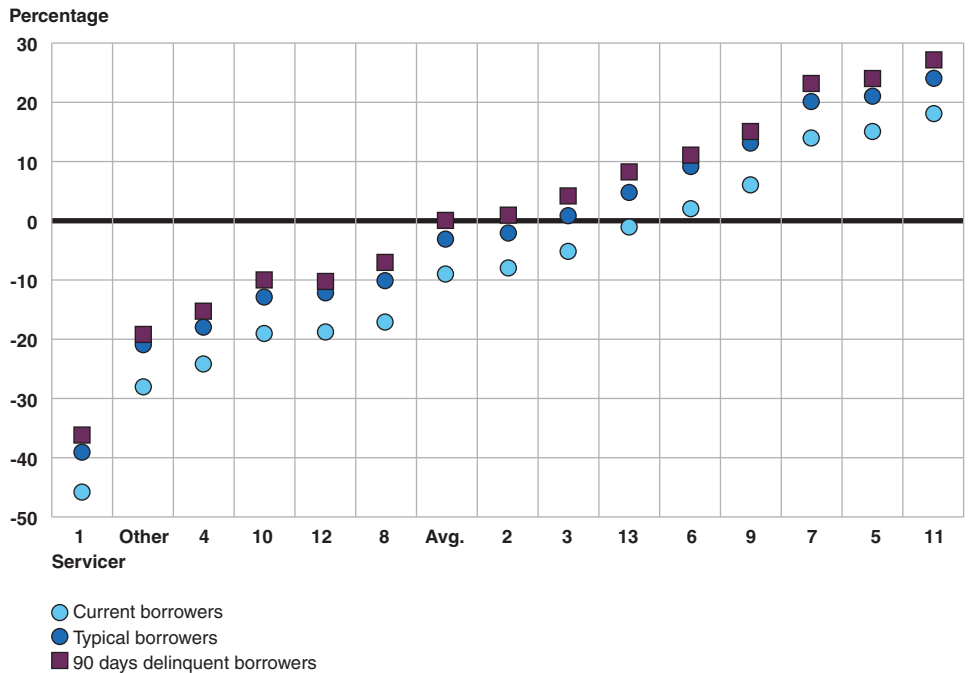
- *MLTV ratios.* Loans with an LTV between 120 and 140 percent were 7 percent less likely to be canceled, while loans with an LTV of more than 140 percent were 8 percent less likely to be canceled, compared to those with MLTV 80 percent or less. This effect is contrary to expectation. The reason for this outcome is while borrowers with high MLTV were more likely to have their trial modifications canceled due to not making their payments, they were disproportionately less likely to have their trial modifications canceled because of insufficient documentation, compared to those with MLTV at or below 80 percent.
- *Principal reductions.* Loans that received principal reductions in the form of principal forgiveness of between 1 and 50 percent of their total loan balance were 6 percent less likely to be canceled compared with those that did not receive principal forgiveness. We note that only about 2 percent of the loans have received principal forgiveness.⁹
- *Servicer effects.* We estimated the changes in the likelihood of cancellation for the servicers using the marginal effects in table 4. To examine the extent to which there is variation in the likelihood of cancellation across servicers, we defined three distinct borrower profiles and calculated the likelihood of cancellation for each of these borrower profiles for each servicer. The “typical” borrower profile used mean values for the borrower population; the “current” borrower profile used mean values for all characteristics except that the borrower was assumed to be current (less than 30 days delinquent); and the “delinquent” profile used mean values for all characteristics except that the borrower was assumed to be delinquent by 90 days or more. Because delinquency status predicts higher likelihood of cancellations for borrowers who are seriously delinquent (90 days or more delinquent) compared to being current (less than 30 days delinquent), the likelihood of cancellation increases with increased delinquency for each servicer.

The results presented in fig. 9 show significant variation across the servicers for cancellations of trial modifications. In particular, for the large servicers, the likelihood of cancellation increased for about one-half of them (ranging from 1 to 24 percent) but decreased for the other half (ranging from -2 to -39 percent) for the “typical” borrower. Although the major reasons for the cancellations vary across the servicers, they were

⁹Loans that received principal forbearance were 3 percent less likely to be canceled, and about 20 percent of the loans received this form of principal reduction.

primarily due to incomplete documentation, trial plan default, and ineligible mortgage.

Figure 9: Estimated Change in Likelihood of Cancellation of HAMP Trial Loan Modification by Servicer, Delinquency Status Before Modification

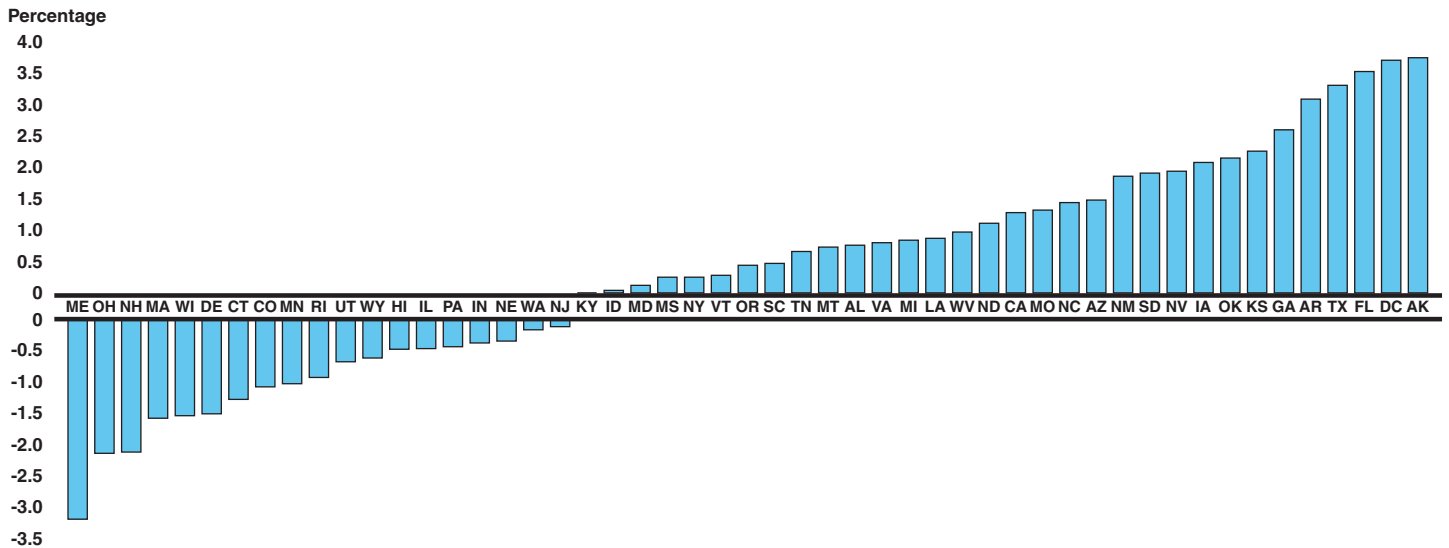


Source: GAO.

Note: "OTH" means the group of non-large servicers; the numbered servicers refer to "large" servicers, and "AVG" is the average values for all the servicers in the sample. The "typical" borrower profile is based on the mean values for the borrower population; the "current" borrower profile used mean values for all characteristics except that the borrower was assumed to be less than 30 days delinquent; and the "90DQ" profile used mean values for all characteristics except that the borrower was assumed to be delinquent by 90 days or more, and the property is assumed to be in California. Assuming other states will change the probabilities but not the pattern of the likelihoods across the servicers. The changes in likelihoods of cancellation of trial modifications for each large servicer are compared to the "OTH" servicers.

- *State-level effects.* For the state-level effects we estimated the change in the likelihood of trial cancellations across the states using the marginal effects in table 4, similar to the analysis of the servicer effects. The results presented in fig.10 show that the changes in the likelihoods of cancellations are higher in most of the states, including high mortgage foreclosure states such as Arizona, California, Florida, Michigan, and Nevada—which have over 40 percent of the trial loans.

Figure 10: Estimated Change in Likelihood of Cancellation of HAMP Trial Loan Modification by State



Source: GAO.

Note: The changes in likelihoods of cancellation of trial modifications for each state are compared to the state of Wyoming, the base state used to obtain the regression estimates.

Several checks were conducted to ensure that our results are reliable—including the sample used, model specification, and estimation techniques.¹⁰ In all cases, our key results were generally unchanged. Specifically, we excluded the servicer effects and state-level effects, and included the start time of the trial to account for the housing and economic conditions at the time of the modification.¹¹ We also estimated robust standard errors to ensure that the tests of significance are reliable. Furthermore, although we could not use the fixed-effects technique to control for unobserved heterogeneity across the borrowers because we do not have repeat observations on the borrowers, we attempted to incorporate unobserved heterogeneity among the borrowers using mixed multinomial logit estimation. This is intended to help capture the

¹⁰The key results were generally unchanged when we used all the trial loans, including the newer trial modifications from July 2010 to September 2010.

¹¹We used a variable for the month of the year when the trial started to capture the contemporaneous economic conditions when the loan entered the trial plan. In order to obtain valid estimates, since both the start time for the trial and the stated income variable—which are both time-related—overlap, we excluded the stated-income variable when the start-time variable was included.

differential in risk preferences and idiosyncratic differences among the borrowers that are not captured by the explanatory variables in the models we estimated.¹² However, we could not estimate the mass point locations with any precision. Finally, we noted that since loans enter and exit HAMP over time, these results may not necessary pertain in the future.

¹²See Anthony Pennington-Cross, "The Duration of Foreclosures in the Subprime Mortgage Market: A Competing Risk Model with Mixing," *Journal of Real Estate Finance and Economics*, vol. 40:109–129, 2010 for a discussion of this approach.

Appendix III: Comments from the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

February 23, 2011

Thomas J. McCool
Director, Center for Economics
Applied Research and Methods
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. McCool:

Thank you for providing the Department of the Treasury ("Treasury") an opportunity to review and comment on your draft report on Treasury's Making Home Affordable ("MHA") program, *Treasury Continues to Face Implementation Challenges and Data Weaknesses in Its Making Home Affordable Program* ("Draft Report"). Thank you as well for meeting with my staff on Friday, February 18, 2011.

We appreciate GAO's efforts in assessing the housing programs initiated under Treasury's Troubled Asset Relief Program ("TARP"). As set forth in the Draft Report, these include GAO's analysis of homeowners helped by Treasury's Home Affordable Modification Program ("HAMP"), the first-lien program, and its survey of servicers and counselors regarding borrowers who did not receive permanent modifications under this program. We also acknowledge the Draft Report's description of the operational capacity and infrastructure challenges faced by servicers in implementing Treasury's housing programs.

In addition, GAO's research into proprietary modifications made by servicers outside the MHA program is useful. There is little available data concerning these proprietary modifications, and the more that we understand their terms and outcomes, the easier it will be for policymakers and regulators to craft appropriate changes to MHA and other housing programs aimed at preventing avoidable foreclosures.

As we described during our February 18 meeting, however, we believe that the Draft Report raises certain criticisms regarding the design and implementation of MHA that are unwarranted. First, GAO criticizes Treasury for the number of changes made to its housing programs following their implementation, and Treasury's alleged failure to incorporate the lessons it learned from the first-lien HAMP program into the roll out and design of other MHA programs, such as the Home Affordable Foreclosures Alternatives ("HAFA") Program.

Though we acknowledge that subsequent programs have not been implemented as quickly as initially expected, GAO's criticism seems to ignore the context in which these decisions were made and the tradeoffs Treasury was forced to make. In the spring of 2009, when MHA was

initiated, we faced the worst housing crisis since the Great Depression. It was imperative that Treasury launch a program to address this need and set aggressive implementation schedules to push servicers, investors and homeowners to work together. Mortgage modifications had never been done on this scale; servicer participation was voluntary; and the housing market was constantly changing. Over time, changes had to be made to the programs to respond to lessons learned from the implementation process. In addition, MHA considered and incorporated many suggestions from the GAO and other oversight agencies. We believe any critique of our implementation efforts should acknowledge the need to launch the programs quickly, within the constraints of existing investor contracts and regulatory guidelines, and refine them over time.

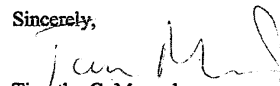
Second, GAO's comparison of HAMP modifications to proprietary modifications based on its survey of borrowers' experience with privately-offered proprietary programs also does not tell the entire story. While it is certainly appropriate for GAO to assess Treasury's performance based on the goals of the HAMP program, we do not believe it is constructive to assess HAMP's performance based on the goals of proprietary programs that are not government supported. This is particularly true because Treasury has no authority over proprietary modifications and servicers are not required to report on their modifications. Because servicers are required to consider homeowners for HAMP modification before they are considered for proprietary modification, much of the initial underwriting is completed during the HAMP evaluation, enabling a more streamlined approach to any subsequent proprietary modification.

Third, GAO criticizes the completeness and quality of the data collected by Treasury related to HAMP modifications, and concludes that "missing or inaccurate information limits Treasury's ability to identify program gaps." We disagree with this conclusion. The information contained in the MHA Data File is collected from homeowners applying to HAMP by their mortgage servicers. This data is not verified by Treasury, and is occasionally incomplete; for example, because a homeowner learns he is ineligible for HAMP before all his information is collected.

In suggesting that this "missing or inaccurate" information is critical to Treasury's ability to identify gaps in HAMP, the Draft Report appears to ignore that the quality of existing data on permanent HAMP modifications is far superior to that collected for trial modifications based on stated income, and that the quality of data regarding trial modifications has greatly improved since Treasury began requiring verified income.

We have attached more detailed comments in the appendix. In closing, I want to reiterate my appreciation for GAO's ongoing assessment of the TARP housing programs, and suggest that a balanced analysis or critique of these programs must recognize how these unprecedented circumstances have shaped our actions. We look forward to continuing to work with you and your team in our ongoing efforts to stabilize the financial system.

Sincerely,



Timothy G. Massad
Acting Assistant Secretary for Financial Stability

Attachment

Appendix

The following are more detailed comments and responses to findings and criticisms in the Draft Report and should be read together with the attached Comment Letter.

See comment 1.

Criticism of Treasury for not applying lessons learned from first lien program to subsequent programs (pages 18-26): In 2009 and 2010, the housing crisis continued to present challenges, moving from a crisis involving certain kinds of loans to widespread foreclosures from unprecedented rates of unemployment. It was precisely because of lessons learned from the first lien program that we were able to create guidelines and aggressive implementation schedules for other MHA programs in a relatively short period of time. Treasury conducted a thorough analysis and engaged in extensive discussion with our agents and servicers about operational challenges and the most efficient mechanisms before launching each program.

Time is of the essence for delinquent borrowers or those at risk of delinquency. While the Draft Report discusses complaints of servicers about the programs, it fails to acknowledge that the servicers discussed and agreed to these timelines and implementation schedules. Also absent from the Draft Report is the fact that if servicers do not agree with or cannot support the changes, they have the option of filing for a waiver or opting out of the program. When circumstances demonstrate the need for changes to make sure the programs help as many eligible homeowners as possible, Treasury does not hesitate to make those changes as promptly as practicable.

See comment 2.

Criticism of the database for second liens (pages 13, 25): The Draft Report criticizes Treasury for a lack of a database that includes second liens matched to HAMP modified first liens. Treasury created a system in which LPS enters into a contract with servicers to match HAMP modified first to second liens. Prior to Treasury establishing the Second Lien Modification Program, there was no national system to match liens. Challenges in this type of system are inevitable as data is collected differently depending on the servicer or lien holder's approach and the large number of liens involved.

See comment 3.

Criticism of "extensive program requirements" (pages 15, 51): The Draft Report suggests that Treasury's extensive program requirements are an obstacle to success. This criticism fails to recognize that most of these requirements were created because 1) it is a government program that is tasked with spending and accounting for taxpayer dollars in a responsible and efficient manner and 2) some of the reasons behind the housing crisis had to do with a lack of requirements and supporting documentation.

In addition to servicer complaints about extensive program requirements mentioned in the Draft Report, the servicers apparently complained about "unclear guidance" (see p. 21) with regard to the programs. As stated above, the servicers were involved in discussions about the program guidelines, their operational needs, and agreed to aggressive timelines and implementation schedules. Additionally, each servicer has a designated MHA representative from Treasury's Program Administrator, whose purpose is to work through issues, answer questions, and provide clarifications on program guidance when needed.

See comment 4.

Criticism for failure to set goals (pages 11, 24, 53): The Draft Report faults Treasury for failing to set numerical goals, especially with regard to the new programs. These programs are launched under challenging and unprecedented circumstances, making it extremely difficult to predict how many homeowners will respond to servicer solicitation, provide requisition documentation or accept the modification when offered. We focus on goals over which we have some control. For example, we require servicers to contact every eligible borrower to assess for a modification or alternative loss mitigation program. And, because we only pay for success, one can still evaluate whether the programs are well constructed, are a prudent use of taxpayer funds, and balance the needs of the interested parties, e.g., borrowers, investors and taxpayers. In addition, if we focused only on numbers of borrowers in programs, there may be a misdirected incentive to get borrowers into programs at the expense of ensuring sustainable results for those borrowers.

See comment 5.

HAMP modifications compared with Proprietary Modifications (pages 44-49): The Draft Report suggests two general criticisms or findings with regard to HAMP modifications in the context of proprietary modifications:

1. *Treasury does not collect data on proprietary modifications:* The Draft Report leaves the impression that Treasury does not *choose* to collect data on proprietary modifications. Treasury does collect data on proprietary modifications and post-HAMP dispositions that are provided via a survey of a certain representative sample of servicers that is submitted to Treasury on a voluntary basis. But because proprietary modifications are by definition not implemented pursuant to HAMP, servicers are not required under the HAMP contract to disclose terms of their proprietary modifications. In order to obtain additional information, Treasury works closely with the Hope Now Alliance and has encouraged HOPE Now to provide more detail on proprietary modifications, including percentages of payment reductions and percentages with terms exceeding five years.
2. *Proprietary modifications are more flexible and easier to secure than HAMP modifications:* Treasury operates a national, publicly financed government program and must balance the interests of taxpayers, investors and borrowers in designing and implementing the programs. Eligibility standards and documentation requirements are a necessary part of balancing those interests and complying with our Congressional mandate of developing a program designed to prevent avoidable foreclosures while protecting the taxpayer. To relax eligibility standards or documentation requirements would unnecessarily put taxpayers' interests and the goal of sustainable results for borrowers at risk. Private entities operating proprietary programs are not under such constraints.

See comment 6.

In addition, in the absence of MHA, there is little reason to believe that servicers would be offering the type of proprietary modifications now offered. Prior to the crisis and the implementation of MHA programs, servicers had little to offer in terms of modifications.

See comment 7.

Criticisms on data collection (pages 26-44): We believe the overall conclusion reached in the Draft Report – that the gaps in the data limit our ability to identify program gaps – is inaccurate and misleading. Some of the examples of missing or inaccurate data are outliers (see p. 26, 32)

See comment 8.

and not representative of the quality of the data Treasury collects. Data on permanent modifications is robust, allowing Treasury to determine gaps in programs and how to make improvements. Treasury relies on data provided by the borrowers to the servicers and it has improved significantly over the past six months, especially as the program moved to verified income.

Post-HAMP disposition paths: The data for the Disposition Path tables in the Public Report are provided by the top eight servicers through monthly survey responses with specific instructions to ensure that the sum of all disposition categories equals the total population of borrowers being reported. This is done to provide a clear view of the current path the population is following through the progression of potential loss mitigation outcomes. This approach avoids double counting a borrower who may be in process of consideration for a proprietary modification while requesting consideration for a short sale, and also clarifies that the borrower is on a path for a solution rather than abandoned to a foreclosure end.

See comment 9.

Criticism for failure to fully implement 2MP, HAFA and FHA Refinance housing programs (page 51): The programs have been fully implemented though reporting on the programs is still underway. There is always a lag time between implementation and reporting, for a variety of reasons, including the need to verify the data. Therefore, we disagree with GAO's conclusion that we have failed to fully implement these programs.

Absent from the report is any recognition of some of the difficulties Treasury encountered in getting these programs established. Some of these difficulties included lack of GSE participation in the FHA Refinance program, a different set of guidance for HAFA and varying bank policies on pursuing deficiency judgments under HAFA. Without these impediments, and others, Treasury's ability to efficiently implement and gain participation in these programs would be significantly improved.

The following are GAO's comments to the Department of the Treasury's letter dated February 23, 2011.

GAO Comments

1. We acknowledge that Treasury's HAMP program is part of an unprecedented response to a particularly difficult time in our nation's mortgage markets. As noted in the report, we also acknowledge that Treasury took steps to consult with servicers on the design and implementation of 2MP, HAFA, and PRA. However, Treasury has repeated some of the practices that were the focus of previous recommendations we had made for the first-lien program in its implementation of its newer MHA programs. For example, in July 2009, we recommended that Treasury develop a means of systematically assessing servicers' capacity to meet program requirements during program admission. While Treasury has begun assessing servicers' capacity to implement 2MP, HAFA, and PRA, it has not ensured that servicers have sufficiently demonstrated they have the capacity to successfully and expeditiously implement these programs. In addition, we recommended in June 2010 that Treasury finalize and implement benchmarks for performance measures under the first-lien modification program, as well as develop such measures for the newly announced programs. Treasury has not developed these benchmarks, either for the first-lien or the subsequent programs, making it difficult to hold servicers accountable for performance and assess the extent to which they have been successful. The pages referenced in this comment are now pages 20 to 24.
2. Treasury indicated that the draft report criticized it for a lack of a database that includes second liens matched to HAMP-modified first liens. The draft report does not criticize Treasury for the lack of a database. Rather, the report notes that Treasury worked with LPS to develop a database and has taken steps to improve the quality of the data. We also note that servicers reported difficulties with the matching of first and second liens, including concerns about the accuracy and completeness of the data, which contributed to the slow initial implementation of 2MP. As a result of these challenges, servicers had been modified relatively few second liens a year after program guidelines were issued. The pages referenced in this comment are now pages 13 and 24.
3. Treasury noted that the draft report suggested that extensive program requirements and unclear guidance were obstacles to the program's success. The section of the draft report that discussed concerns about

extensive program requirements was associated with the implementation challenges with the HAFA program only. The draft report noted that Treasury itself has acknowledged these obstacles and has since revised many of the HAFA program requirements that were identified as contributing to the slow implementation of the program. With regard to Treasury's comments about program guidance, we clarified the language in the report to focus on the programs' changing guidance. Servicers told us that ongoing program revisions presented challenges such as needing to retrain staff and in some cases delayed program implementation. The pages referenced in this comment are now pages 15 and 48.

4. Treasury noted that the draft report faulted Treasury for failing to set numerical goals, especially with regard to the new programs. Treasury stated the programs were launched under challenging and unprecedented circumstances, making it extremely difficult to predict how many homeowners will respond to servicer solicitations, provide requisition documentation, or accept the modification when offered. As we, the Congressional Oversight Panel, and SIGTARP have previously noted, establishing key performance metrics and reporting on individual servicers' performance with respect to those metrics are critical to transparency and accountability. As such, we continue to believe that it is important that Treasury implement our June 2010 recommendation that it develop measures and benchmarks for its newer MHA program. Without pre-established performance measures and goals, Treasury will not be able to effectively assess the outcomes of its MHA programs or hold servicers accountable for their performance. The pages referenced in this comment are now pages 12, 23, and 49.
5. Treasury stated that the draft report left the impression that Treasury chose not to collect data on proprietary modifications. In fact, the report notes that Treasury does collect data on the post-HAMP disposition paths. We believe the information that Treasury collects through its eight largest HAMP servicers provides important and useful information to policymakers on the disposition of borrowers denied or canceled from HAMP trial and permanent modifications. However, as noted in the draft report, we believe the way in which the information is collected makes it difficult to understand the outcomes of these borrowers. Without accurate reporting of borrower outcomes, Treasury cannot know the actual extent to which borrowers who are denied, canceled, or redefaulted from HAMP are helped by other programs or evaluate the need for further action to assist this group of

homeowners. The pages referenced in this comment are now pages 41 to 45.

6. Treasury commented that the draft report suggested a criticism of HAMP modifications because it notes that proprietary modifications are more flexible and easier to secure than a HAMP modification. Treasury notes that it manages a national, publicly financed program and must balance the interest of taxpayers, investors, and borrowers in designing and implementing the program. We agree. Our observation is not intended to suggest that HAMP adopt the flexibility of proprietary modifications. We are simply describing what is known about proprietary modifications. Moreover, the report notes that the long-term sustainability of both types of modifications is unclear, particularly for proprietary modifications because these modifications may not reduce the monthly payments of borrowers as much as HAMP modifications have. The pages referenced in this comment are now pages 41 to 45.
7. Treasury stated that it believed that the overall conclusion reached in the draft report that the gaps in data limit Treasury's ability to identify program gaps is inaccurate and misleading. Treasury noted that some of the examples of missing or inaccurate data are outliers. It also noted that the data on permanent modifications is robust and that data provided by servicers has improved significantly over the past 6 months. We have added text in the report to acknowledge that Treasury's data, particularly on the race and ethnicity of borrowers, has improved over time, and that the reporting in the most recent public file represents an improvement over the data we received as of September 30, 2010. We also note that Treasury has worked with Fannie Mae to make improvements to the data. While we acknowledge that progress has been made in the quality and accuracy of the data reported by servicers, we believe that it is critical that Treasury continue to work toward improving the data so that it and policymakers can understand the characteristics of both borrowers who have been helped by HAMP as well as those who could not be helped by HAMP. This information will be essential to identifying what additional steps or adjustments could be made to existing TARP-funded programs or other government programs to prevent avoidable foreclosures to better achieve the goals of preserving homeownership and protecting property values. The pages referenced in this comment are now pages 25 to 40.

8. Treasury stated that it instructed servicers to report borrowers in a single disposition path to avoid double counting of borrowers and, thereby, provide a clear view of the current path the population is following through the progression of potential loss mitigation outcomes. However, the current method of data collection can distort the current disposition status of borrowers because borrowers are often “dual-tracked” (e.g., being evaluated for a proprietary modification while also starting the foreclosure process). Reflecting the full range of possible outcomes these borrowers face would improve Treasury’s understanding of the extent to which borrowers are helped by other programs and assist any evaluation of the need for further action to assist this group of homeowners.

9. Treasury stated that it disagreed with the draft report’s conclusion that its programs had not been fully implemented. We revised the language in the report to more clearly state that the implementation of Treasury’s MHA programs had gotten off to a slow start and reiterated that actions needed to be taken by Treasury to better ensure the success of its programs. The page referenced in this comment is now page 47.

Appendix IV: GAO Contacts and Staff Acknowledgments

GAO Contacts

Mathew J. Scirè (202) 512-8678 or sciremj@gao.gov

Staff Acknowledgments

In addition to the contacts named above, Lynda Downing, Harry Medina, John Karikari (Lead Assistant Directors); Tania Calhoun; Emily Chalmers; William Chatlos; Grace Cho; Rachel DeMarcus; Marc Molino; Mary Osorno; Jared Sippel; Winnie Tsen; Jim Vitarello; and Heneng Yu made important contributions to this report.

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