Mortgage Loan Modifications Failing to Prevent Foreclosure for Many

November 5, 2013 - 27% of consumers who have received loan modifications under the government's HAMP program have redefaulted on their home mortgages. That according to a report by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). The new report, which is congressionally mandated, paints a troubling picture of a program that was supposed to keep consumers out of foreclosure. Instead, the number of defaulting borrowers in the program is now expected to continue its meteoric climb even as the government and lenders move quickly to enroll more participants.

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When HAMP was introduced, ACCESS had grave concerns about it which we made known at the time. One of the primary issues with HAMP (and other government mortgage programs that were a part of the bailout in 2008) was that loan servicers were given wide discretion about who to offer loan modifications to. The way that the programs were initially structured, lenders could take the riskiest loans in their portfolios and move them into a government backed mortgage. This had the perverse effect of converting loans given to borrowers who couldn't afford them in the first place, and with no taxpayer money at risk, to federally backed mortgages. One minute, all of the risk belonged to the lender and the next it was foisted upon the taxpayer.

Since the programs were initiated, the rules have changed somewhat. HAMP in particular requires lenders participating in the program to do an evaluation of the property in default before moving ahead with a foreclosure or loan modification. If the lender would receive more money in a foreclosure, the lender may proceed with the foreclosure. But if the lender would receive more money through a loan modification, the lender is required to offer a modification and halt all foreclosure activity.

Out of the 8 million or so mortgages that were originally envisioned to receive assistance through HAMP, 1.25 million households have been enrolled. (NOTE: Of the nearly $20 billion in assets the government is using to back the program, only $4.4 billion has been committed.) Of those, 27% have defaulted a second time and have been forced out of HAMP into foreclosure or another private loan modification. Fully 10% of current HAMP participants are 1 to 2 months behind in their payments.

Consumers who have participated in the program for the longest period of time are also the most likely to default. The default rate among those who enrolled in the program early on is more than 46%. As newer mortgages in the program age, the redefault rates on them are also continues to climb. Clearly, something is amiss.

HAMP was originally slated to stop taking new enrollees at the end of 2012. The Treasury Department (which administers HAMP) has now extended the program to run through December 31, 2015. Unfortunately, they have not put procedures in place to slow the default rate for new enrollees. Additionally, the program appears to continue to encourage misconduct by lender/servicer participants. In its report, SIGTARP said, "HAMP is a program that has been plagued with servicer misconduct." The report then goes on to state that Treasury should examine each participant to see if their conduct has contributed to high redefault rates. That suggestion appears to have been rejected out of hand by Treasury with the simple, one-line statement, "that not all [borrowers in HAMP] will succeed.â€•

According to the report, HAMP redefault costs to taxpayers so far stand at $815 million. As you will see, this number is likely to increase significantly.

Redefault Rates Not Uniform Across Country

While redefault rates appear to be high nationally, they are not uniformly distributed. Mississippi has the highest rate at 35%. Twenty other states have rates of 30% or more. California has the lowest rate of any state at 20%. NOTE: Puerto Rico and the US Virgin Islands have rates lower than 20% but both have relatively few HAMP participants.
Other Factors

A wide variety of other factors appear to play into redefault by borrowers. Here are some interesting statistics from the report.

In cases where a HAMP modification included a reduction in the amount of principle that the borrower owed, redefault rates are cut to 14%.

In cases where the borrower's debt to income ratio was cut by 10 points, redefault rates drop to 21%.

Redefault rates among borrowers with a credit score of 620 or higher are 15%. Among borrowers with credit scores below 620, redefault rates are 31%

Finally, of homeowners who owed more on their home than it was worth after a loan modification, default rates are 28%. Homeowners who have equity in their home after a loan modification have a redefault rate of 21%. Disturbingly, 70% of HAMP approved applicants owed more on their home than it was worth at the time they applied for the program. After approval, 73% of participants owed more on their home than it was worth. The program is actually increasing the number of people who are underwater on their homes.

Interestingly, those owning their homes for more than five years were much less likely (16%) to redefault than those who had owned their homes for less than five years (31%). Though the report didn't provide any explanation for this, there are likely a wide variety of other factors involved. Among these, longer term homeowners are likely to have some equity in their properties and may have more job security.
Early Warning System

SIGTARP suggests that an early warning system be implemented for HAMP participants to alert lenders and servicers when redefault is likely. Due to the trends in the data, the report suggests than three factors provide the best early warning signs of redefault:

1. Homeowners who receive the least reduction in their mortgage payment and overall debt as a result of HAMP participation;

2. Who are still underwater on their mortgage after a permanent modification is approved, and;

3. Who have subprime credit and a high overall debt burden.

Program participants who fall into all three of these categories are significantly more likely to redefault; some shortly after their loan modifications are approved.

Treasury has been resistant to this suggestion however. SIGTARP made exactly the same recommendation in its July report to congress. So far, nothing has been done to implement it.

Long Term Outlook for HAMP

On a long term basis, the data contained in the report indicates that taxpayers should expect redefault numbers to continue to increase rapidly. This really shouldn't be a surprise to anyone though. 71% of homeowners receiving permanent loan modifications through HAMP have subprime credit scores. 87% of those granted permanent modifications saw no reduction in principle balance owed or an increase in the amount they owed. And, as previously mentioned, 73% of approved participants will owe more on their homes than they are worth even after a HAMP modification.

Based on these numbers, the vast majority of HAMP participants appear meet the early warning standard SIGTARP is suggesting, from the very minute that their loan modifications are approved. This only elongates the agony of participants, taxpayers and the housing market.
Unanswered Questions

The report does a good job of breaking down the numbers but doesn't address some fundamental questions. There is virtually no data in it correlating job loss to redefault rates. It also fails to correlate unplanned medical expenses to redefault. Since these two items are the primary reasons for consumer bankruptcy filings, correlating data could be significant.

The report also fails to link any borrower occupational data with redefault numbers. There may be outside job forces that are not immediately evident without this information. Because HAMP requires participants to provide employment information during the application process, the data should be readily available.
Cold, Hard Truths

Unless the Treasury Department makes fundamental program changes to HAMP and other government backed programs for distressed borrowers, all of these programs are likely to produce increasingly poor results. HAMP is backed by $20 Billion in taxpayer money. Since 2009 a total of $38.5 Billion has been pledged to a wide variety of programs, including HAMP, that were supposed to reduce the number of foreclosures and keep homeowners in their property.

For many participants though, HAMP and its sister programs really only moves them from one bad financial position to another. 20% of completed loan modification under HAMP result in homeowners who owe 170% of what their home is worth. These owners have little if any incentive to continue with their mortgage payments and, other than having to find a new place the live, there is virtually no financial downside to them walking away. But for taxpayers who are responsible for HAMP losses, it's another story.

Another program called HARP - also run by Treasury - has gone through a series of changes that have resulted in minimal lending standards. In what is called HARP 2.0, the standards don't require a loan appraisal or underwriting review, eliminate any limitation on how far underwater the homeowner may be, and reduced the amount of paperwork required for application and approval. While redefault rates for HARP are difficult to find, Treasury is saying publically that the HAMP program has lower default rates than any other of its 14 loan modification programs including HARP.

This means that if all of the money committed across all of these programs is ever actually provided to distressed homeowners, taxpayers can expect to absorb losses of at least $10.3 Billion. And most of that money will be paid, in the form of loan guarantees, to the very same banks which determined that relaxed lending standards being used prior to 2008 were good for business. Of course, this all assumes that redefault rates hold steady at their current levels even though SIGTARP expects them to continue to increase if Treasury doesn't tighten its lending standards.

A very simple rule change would likely help the situation immensely. If consumers seeking a loan modification fail the Early Warning test suggested by SIGTARP, they should be ineligible to use a government guaranteed loan modification in any of the programs available. The current system simply isn't working. It is only delaying the inevitable for many homeowners while putting taxpayer money at risk.

byJim Malmberg

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