

Preventing Foreclosures: Counselors, Servicers, and Loan Modifications

Roberto G. Quercia

Director, Center for Community Capital
Professor, City and Regional Planning
University of North Carolina, Chapel Hill

Center *for* Community Capital
*Research and analysis on the
transformative power of capital*

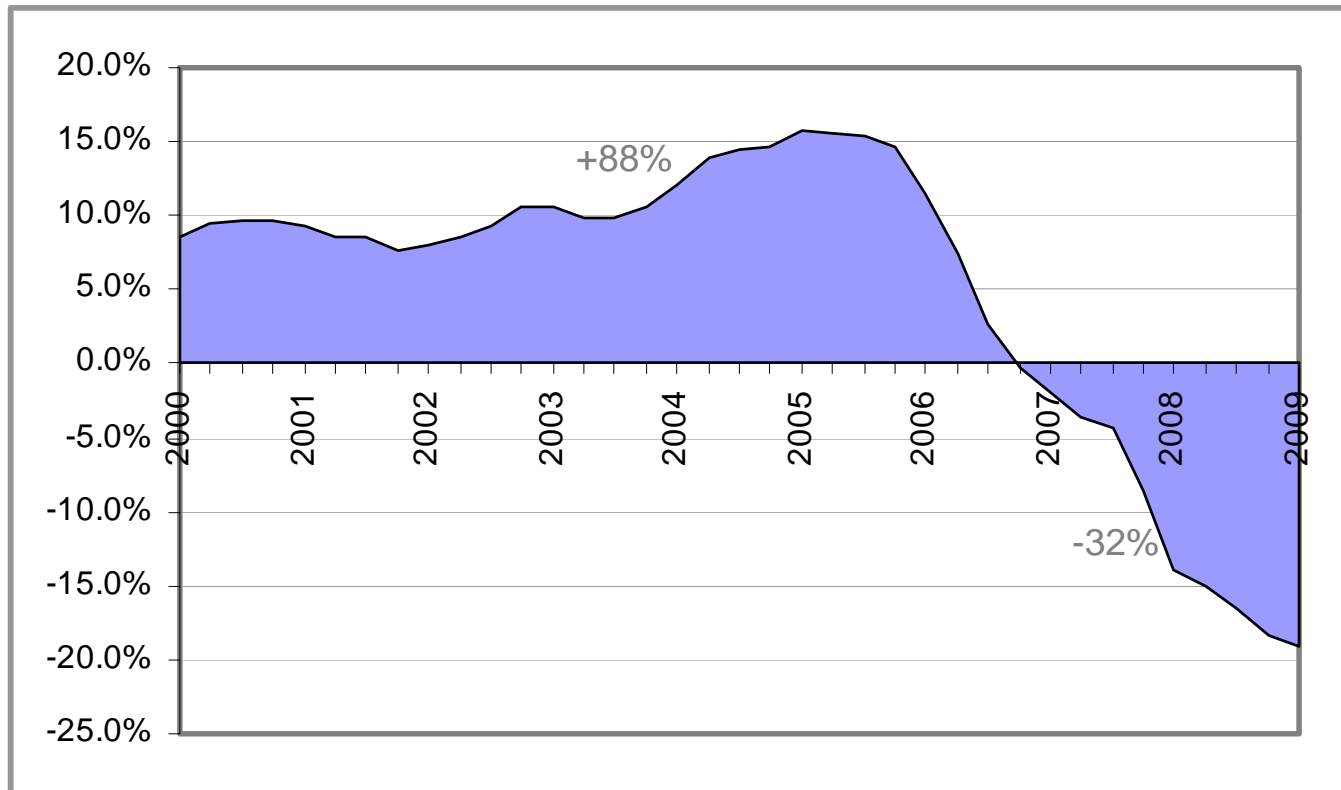


Outline of the Presentation

- Characterizing the foreclosure problem
- Dealing with the crisis
 - Counselors and servicers
 - Loan modifications
- Looking ahead



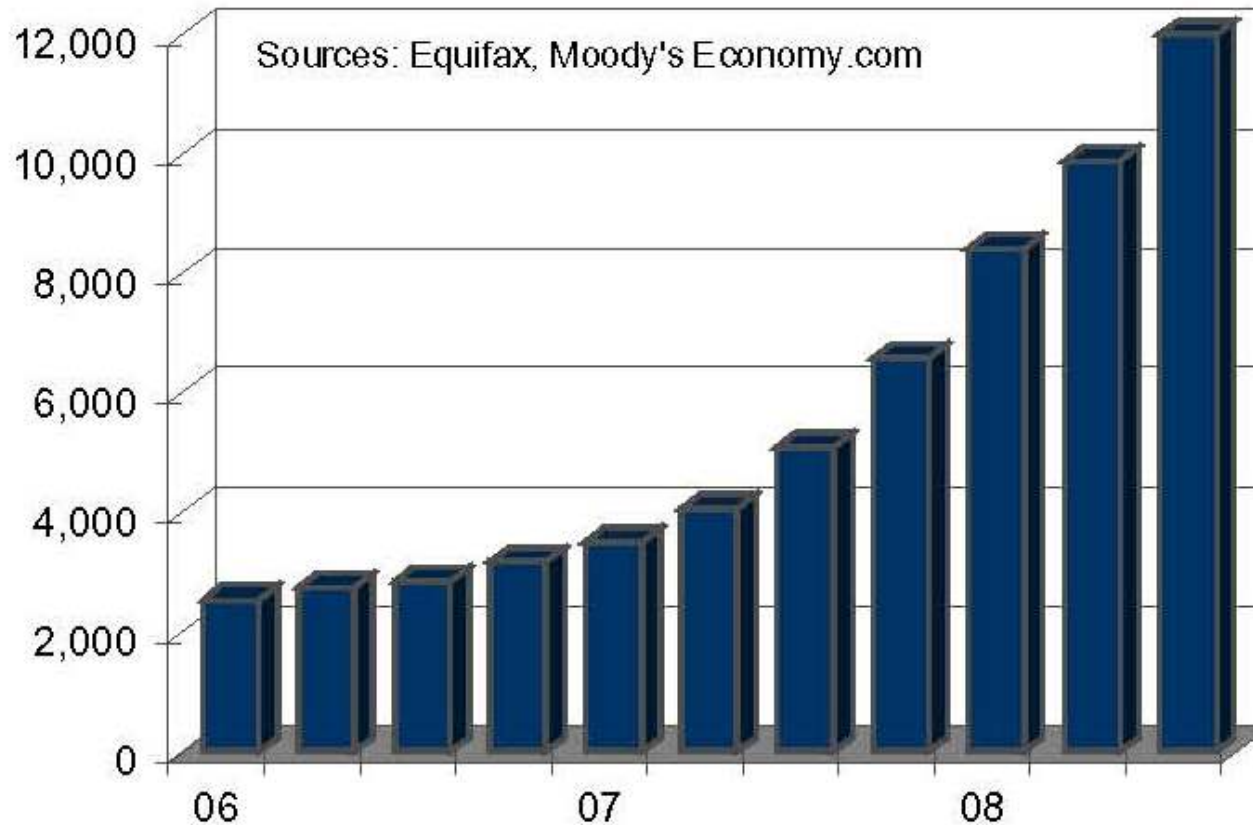
Annual Change in U.S. Housing Prices (Not Inflation Adjusted, with Cyclical Totals)



Source: Standard&Poor's S&P Case-Shiller Housing Price Indices.



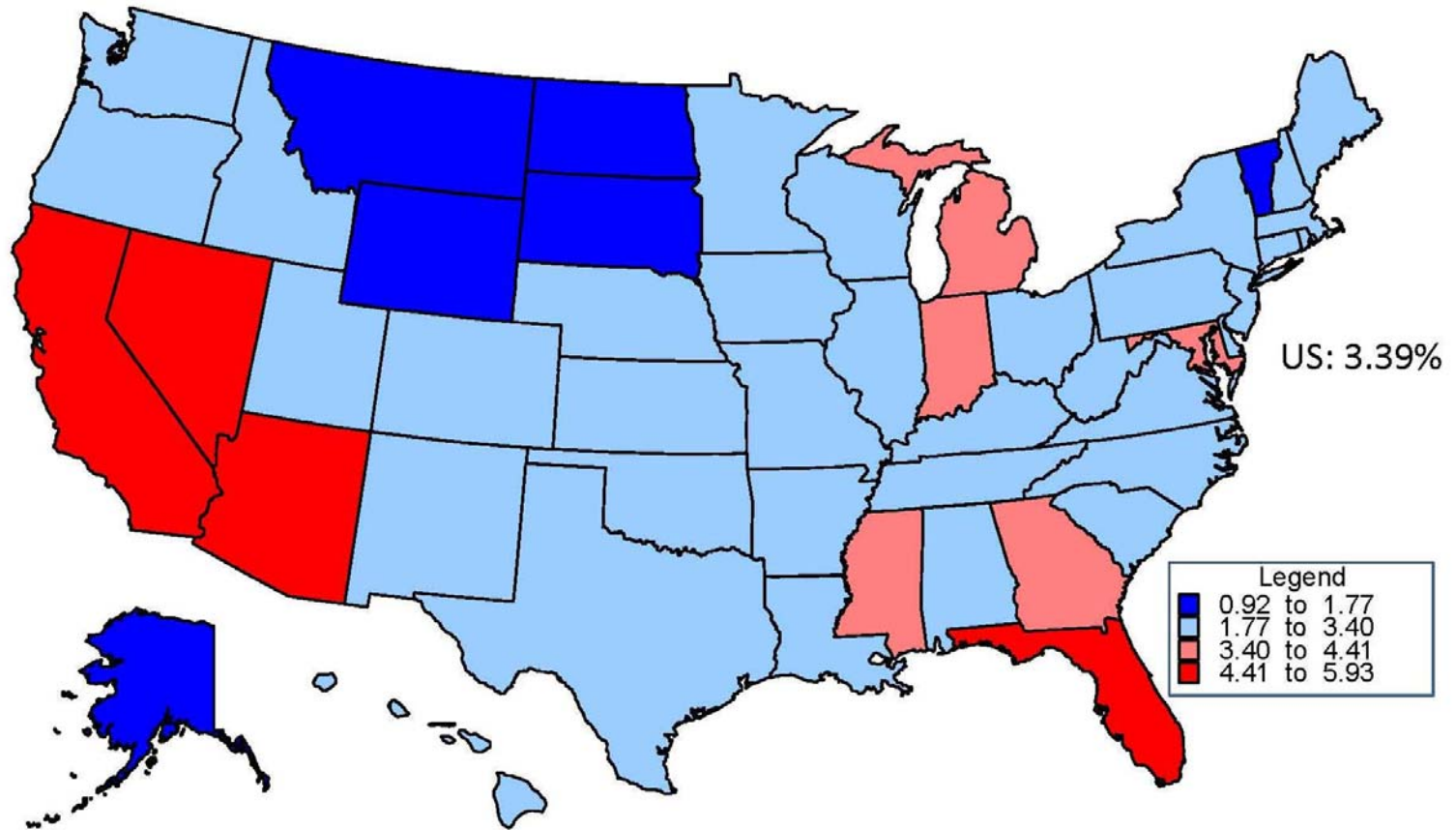
Properties with Negative Equity Increased Sharply Fiserv estimates that 30% of all borrowers are underwater



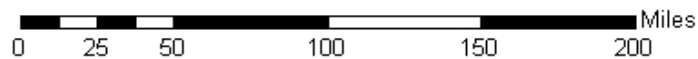
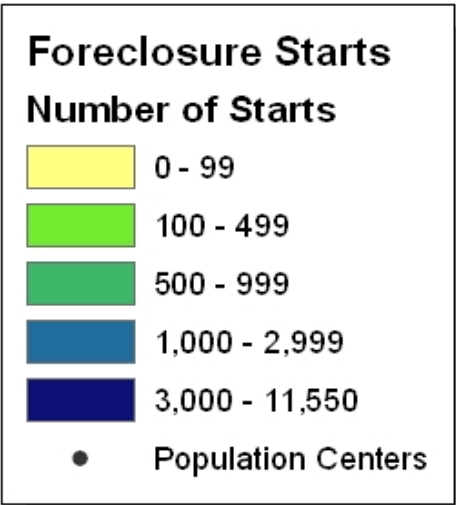
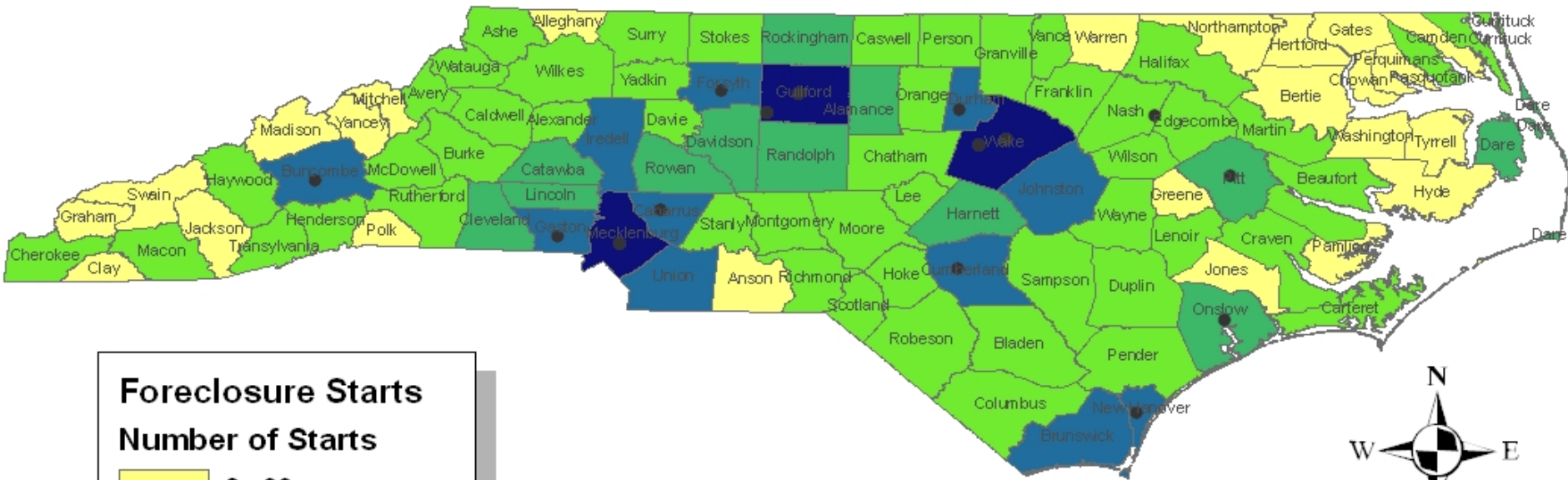
Source: Moody's Economy.com. Unite: 1,000.



State Distribution of 90+day Delinquency Rate, 2009Q1 Great Variation, Not One Problem



Number of Annual Foreclosure Starts in October 2008 - September 2009 by North Carolina County



Source: North Carolina Administrator of Courts Foreclosure Start Data
September 2009

Compiled by: The North Carolina Commissioner of Banks

The Center for Community Capital at
The University of North Carolina at Chapel Hill

Preventing foreclosures: Role of Servicers and Counselors

- “If you are behind on your mortgage loan, contact your lender.”
- Is dealing with a troubled mortgage really that simple?
- We conducted focus group discussions with 40 counselors in 16 agencies in 12 states in all regions of the country between October 2008 and January 2009.

Counseling and foreclosure prevention

- Counselors can be a value-added intermediary for both borrowers and servicers.
- However, counselors are overworked, under-funded, and not used efficiently by servicers.
- Unfortunately, counselors often waste time trying to communicate with servicers, time that could have been spent helping borrowers.

Servicing and foreclosure prevention

- Borrower experiences with servicers can be extremely unproductive and frustrating and are often unsuccessful at keeping borrowers in their homes.
- Indeed, even for the most diligent homeowners or those armed with the assistance of a professional foreclosure prevention counselor, the process of loss mitigation can be lengthy and arduous and likely lead to home loss.
- Lack of capacity and accessibility of loss mitigation personnel at mortgage servicers present serious obstacles to the successful modification of delinquent loans.



Recent signs are positive but...

- With HAMP, servicers are becoming more responsive, a little more willing to seek solutions.
- HAMP implementation has been slow and spotty at a time when demand for assistance has exploded
- Initially, default triggered by a mortgage problem, now an economic problem due to job and income losses on default.
- There is a near total lack of modifications to reduce the loan amounts of the millions of borrowers underwater.
- Servicers and counselors are swamped.



Preventing foreclosures: HAMP

- Home Affordable Modification Program (HAMP)
 - Encourage servicers to modify the loan to 31% DTI
 - Monthly payment reduction cost share
 - Process to be followed to reduce payment: rate reduction, term extension, and then principal forbearance
 - Incentives for servicers and borrowers
 - Home price decline protection incentive
 - Incentive for alternatives: short sale, deed-in-lieu
- No specific guidelines for principal reduction

Obstacles to Principal Reduction

Investors

- NPV
- Market uncertainty and changing policy environment

Servicers

- Friction from securitization (Piskorski et al. 2008, Adelino et al. 2009)
- Lack of incentive to prefer principal reduction

Moral hazard

- Making it less costly for borrower to default, e.g., reducing the principal owed, may result in more defaults than otherwise would have occurred (Ambrose & Capone, 1996).



Data

- 2005-2006 originations securitized (private label), ~ 4 million loans
- Rich data on loan characteristics and loan performance (no income or debt ratio information)
- 51,674 loan modifications reported during the period from January 2008 to November 2008
- Performance observed from mod to February 2009
- Estimated redefault risks and NPV under different modification scenarios

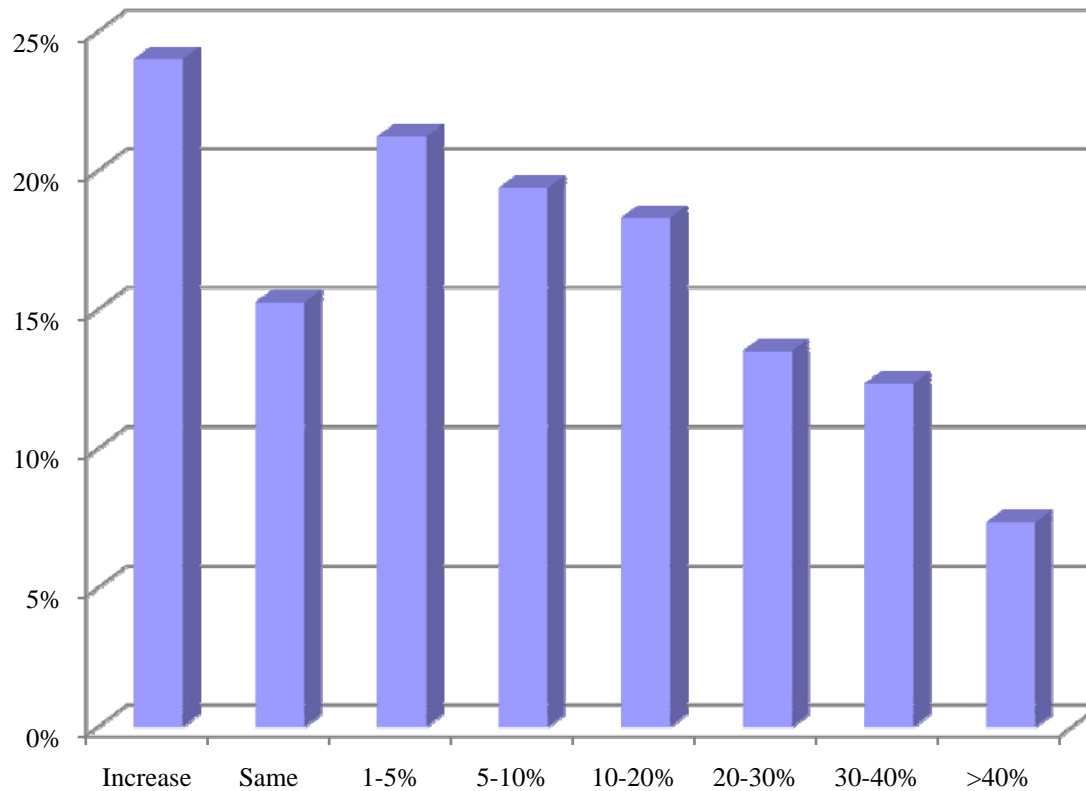


Characteristics of Modified Loans

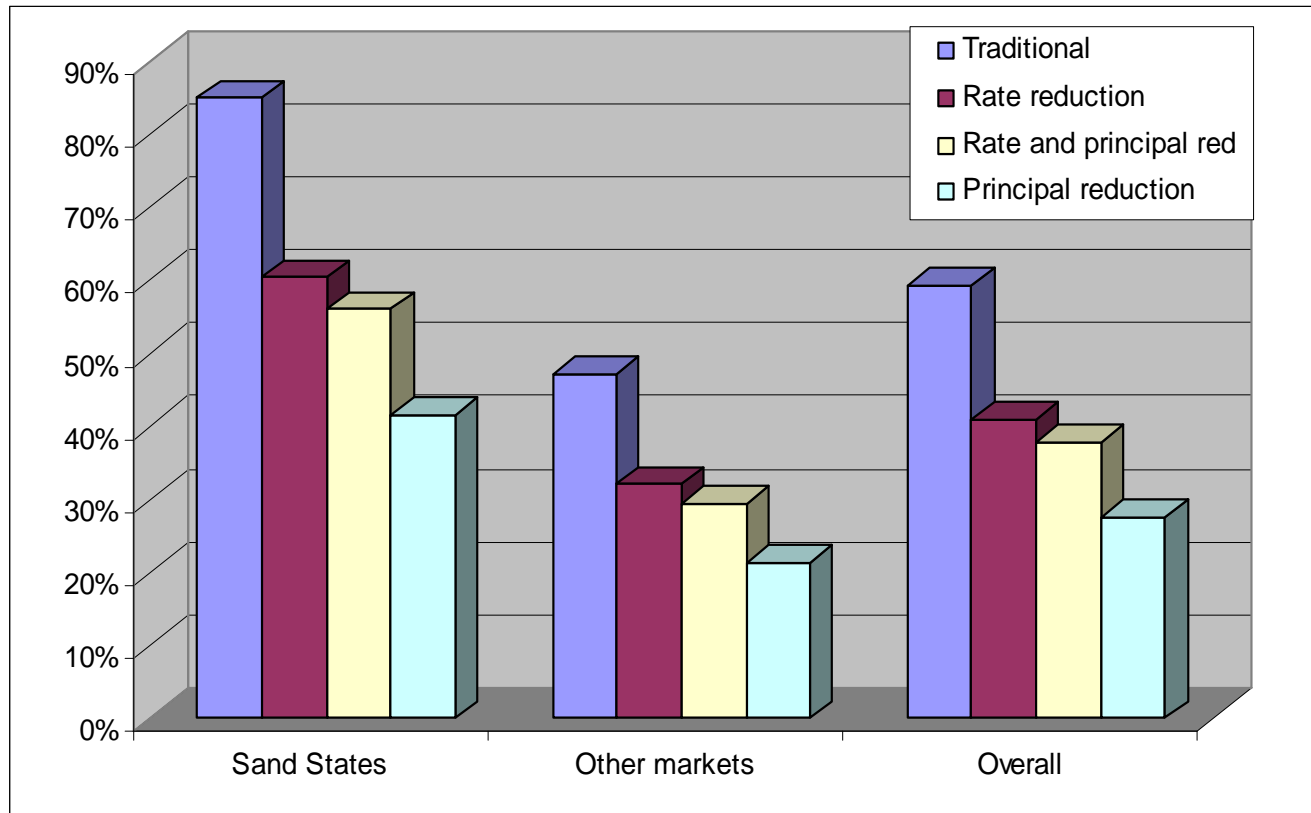
Characteristics	Value (mean or percent)
Origination FICO	614
Home purchase	45%
ARM	88%
Interest Only	24%
30- or 60-day delinquent when mod	19%
90-day delinquent when mod	42%
Loan Modification	
Unpaid balance before mod	\$235,673
Unpaid balance after mod	\$240,659
Interest rate before mod	8.88%
Interest rate after mod	6.82%
P&I payment before mod	\$1,746
P&I payment after mod	\$1,498
Payment higher after modification	53%



Redefault risks and payment reductions (any means)



Principal Reduction Has the Lowest Redefault Rate (Estimated 9-months FC Rates in Different Markets)



Note: * Sand states include CA, FL, NV, AZ. All loan mods result in a payment reduction from 50% DTI to 31% DTI.



NPV: Impact of principal reduction depends on the market

	Loan mod type	Overall	Market1	Market2-4
DTI50toDTI31	Rate reduction	60.49%	54.45%	63.24%
	Principal reduction	59.58%	56.22%	61.07%
	Rate and principal red	60.59%	55.19%	63.03%
	Foreclosure	42.20%	42.20%	42.20%
DTI40 toDTI31	Rate reduction	67.44%	57.78%	71.89%
	Principal reduction	68.57%	61.62%	71.70%
	Rate and principal red	-	-	-
	Foreclosure	42.20%	42.20%	42.20%
DTI55 toDTI31	Rate reduction	60.36%	56.71%	61.98%
	Principal reduction	57.31%	55.76%	57.97%
	Rate and principal red	60.22%	57.59%	61.36%
	Foreclosure	42.20%	42.20%	42.20%
With subsidy * DTI50toDTI31	Rate reduction	62.07%	55.51%	65.06%
	Principal reduction	61.53%	57.79%	63.18%
	Rate and principal red	62.26%	56.37%	64.92%
	Foreclosure	42.20%	42.20%	42.20%

Note: the highlighted numbers represent the highest NPVs among different loan mod types in a market.

Summary and looking ahead...

- Despite positive signs, we conclude that the traditional servicing model is not set up to meet the challenge
- Principal reduction mods have lowest redefault rates
- Principal reduction mods can create even better cash flow for investors in some markets (NPV test)
- More structured guidelines are needed for principal reduction
- Need to examine other alternatives, including short sales



For copies of the studies please visit...

- www.ccc.unc.edu