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# Preserving Homeownership: Foreclosure Prevention Initiatives

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# Summary

The home mortgage foreclosure rate began to rise rapidly in the United States beginning around the middle of 2006 and remained elevated for several years thereafter. Losing a home to foreclosure can harm households in many ways; for example, those who have been through a foreclosure may have difficulty finding a new place to live or obtaining a loan in the future. Furthermore, concentrated foreclosures can negatively impact nearby home prices, and large numbers of abandoned properties can negatively affect communities. Finally, elevated levels of foreclosures can destabilize housing markets, which can in turn negatively impact the economy as a whole.

In the years that followed the increase in foreclosure rates, there was a broad consensus that there are many negative consequences associated with high numbers of foreclosures. There was less consensus over whether the federal government should have a role in preventing foreclosures and, if so, what that role should be. Nevertheless, in the years after the foreclosure rate began to rise, Congress and both the Bush and Obama Administrations created a variety of temporary initiatives aimed at preventing further increases in foreclosures and helping more families preserve homeownership. These efforts included several initiatives that remained active through 2016 or beyond, including

- the Home Affordable Modification Program (HAMP),
- the Home Affordable Refinance Program (HARP),
- the Hardest Hit Fund,
- the Federal Housing Administration (FHA) Short Refinance Program, and
- the National Foreclosure Mitigation Counseling Program (NFMCP).

Two other initiatives, Hope for Homeowners and the Emergency Homeowners Loan Program (EHLP), expired at the end of FY2011.

Some of these federal foreclosure prevention initiatives were criticized as being ineffective or less effective than had been hoped. This led some policymakers to suggest that changes should be made to these initiatives to try to make them more effective, while other policymakers argued that some of these initiatives should be eliminated entirely. For example, in the 112th Congress, the House of Representatives passed a series of bills that, if enacted, would have terminated several foreclosure prevention initiatives (including HAMP and the FHA Short Refinance Program) prior to their intended end dates. However, these bills were not considered by the Senate.

While many observers agreed that slowing the pace of foreclosures was an important policy goal, several challenges have complicated such efforts. These challenges have included implementation issues, such as deciding who has the authority to make mortgage modifications, developing the capacity to complete widespread modifications, and assessing the possibility that homeowners with modified loans might default again in the future. Other challenges have been related to the perception of unfairness in providing help to one set of homeowners over others, the possibility of inadvertently providing incentives for borrowers to default, and the possibility of setting an unwanted precedent for future mortgage lending.

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# Introduction

The home mortgage foreclosure rate in the United States began to rise rapidly around the middle of 2006 and remained elevated for several years thereafter. The large increase in home foreclosures negatively impacted some individual households, local communities, and the economy as a whole. Consequently, an issue before Congress was whether to use federal resources and authority to help prevent some home foreclosures and, if so, how to best accomplish that objective. This report provides background on the increase in foreclosure rates in the years following 2006, describes temporary initiatives intended to preserve homeownership that were implemented by the federal government and remained active through at least 2016, and briefly outlines some of the challenges inherent in designing foreclosure prevention initiatives. Additional foreclosure prevention initiatives that were established in 2007 or after but ended prior to the end of 2016 are described in the **Appendix**.

Foreclosure refers to formal legal proceedings initiated by a mortgage lender against a homeowner after the homeowner has missed a certain number of payments on his or her mortgage. When a foreclosure is completed, the homeowner loses his or her home, which is either repossessed by the lender or sold at auction to repay the outstanding debt. In general, the term "foreclosure" can refer to the foreclosure process or the completion of a foreclosure. This report deals primarily with preventing foreclosure completions.

In order for the foreclosure process to begin, two things must happen: a homeowner must fail to make a certain number of payments on his or her mortgage, and the mortgage holder or mortgage servicer must decide to initiate foreclosure proceedings rather than pursue other options, such as offering a repayment plan or a loan modification. (See the nearby text box explaining the role of mortgage servicers.) A borrower that misses one or more payments is usually referred to as being delinquent on a loan; when a borrower has missed three or more payments, he is generally considered to be in default. Servicers can generally begin foreclosure proceedings after a homeowner defaults on his mortgage, although servicers vary in how quickly they begin foreclosure proceedings after a borrower goes into default. Furthermore, the foreclosure process is governed by state law. Therefore, the foreclosure process and the length of time the process takes vary by state.

### Mortgage Servicers

Mortgage lenders are the organizations that make mortgage loans to individuals. Usually, the mortgage is managed by a company known as a *mortgage servicer*. Servicers usually have the most contact with the borrower, and are responsible for actions such as collecting mortgage payments, communicating with troubled borrowers, and initiating foreclosures. The servicer can be an affiliate of the original mortgage lender or can be a separate company. Many mortgages are repackaged into mortgage-backed securities (MBS) that are sold to institutional investors. Servicers are subject to contracts with mortgage lenders or MBS investors that obligate them to act in the best interest of the lender or investor, and these contracts may limit servicers' ability to undertake some loan workouts or modifications. The scope of such contracts and the obligations that servicers must meet vary.

# Background on Home Mortgage Foreclosures

## Foreclosure Trends

Home prices began to rise rapidly throughout some regions of the United States beginning in the early 2000s. Housing has traditionally been seen as a safe investment that can offer an opportunity for high returns, and rapidly rising home prices reinforced this view. During this housing "boom," many people decided to buy homes or take out second mortgages in order to access their increasing home equity. Furthermore, rising home prices and low interest rates contributed to a sharp increase in people refinancing their mortgages. Some refinanced to access lower interest rates and lower their mortgage payments, while many also used the refinancing process to take out larger mortgages in order to access their home equity. For example, between 2000 and 2003, the number of refinanced mortgage loans jumped from 2.5 million to over 15 million, and the Federal Reserve estimated that 45% of refinances included households taking equity out of their homes.[1] Around the same time, subprime lending also began to increase, reaching a peak between 2004 and 2006.[2] (See the nearby text box for a description of prime and subprime mortgages.)

### Prime, Subprime, and Alt-A Mortgages

***Prime mortgages*** are mortgages made to the most creditworthy borrowers who qualify for the best available interest rates.

***Subprime mortgages*** are made to borrowers who are considered to be riskier than prime borrowers, and carry higher interest rates to compensate lenders for the increased risk. There is no standard definition of subprime mortgages, and the term is defined differently in different contexts. However, they are often defined as mortgages made to borrowers with credit scores below a certain threshold. Subprime mortgages are also more likely than prime mortgages to include certain nontraditional features.

***Alt-A mortgages*** refer to mortgages that are closer to prime but for various reasons do not qualify for prime rates. For example, an Alt-A loan might be made to a borrower with a good credit history, but factors such as the debt-to-income ratio or the level of income and asset documentation prevent the mortgage from being considered prime.

Beginning in 2006 and 2007, home sales started to decline and home prices stopped rising and began to fall in many regions. The rates of homeowners becoming delinquent on their mortgages began to increase, and the percentage of home loans in the foreclosure process in the United States began to rise rapidly beginning around the middle of 2006. Although not all homes in the foreclosure process will end in a foreclosure completion, an increase in the number of loans in the foreclosure process is generally accompanied by an increase in the number of homes on which a foreclosure is completed. According to the Mortgage Bankers Association (MBA), an industry group, about 1% of all home loans were in the foreclosure process in the second quarter of 2006. By the fourth quarter of 2009, the rate had more than quadrupled to over 4.5%, and it peaked in the fourth quarter of 2010 at about 4.6%. Since then, the percentage of mortgages in the foreclosure process has decreased, but as of the end of 2016 remained slightly higher than historical standards. In the fourth quarter of 2016, the rate of loans in the foreclosure process was about 1.5%.

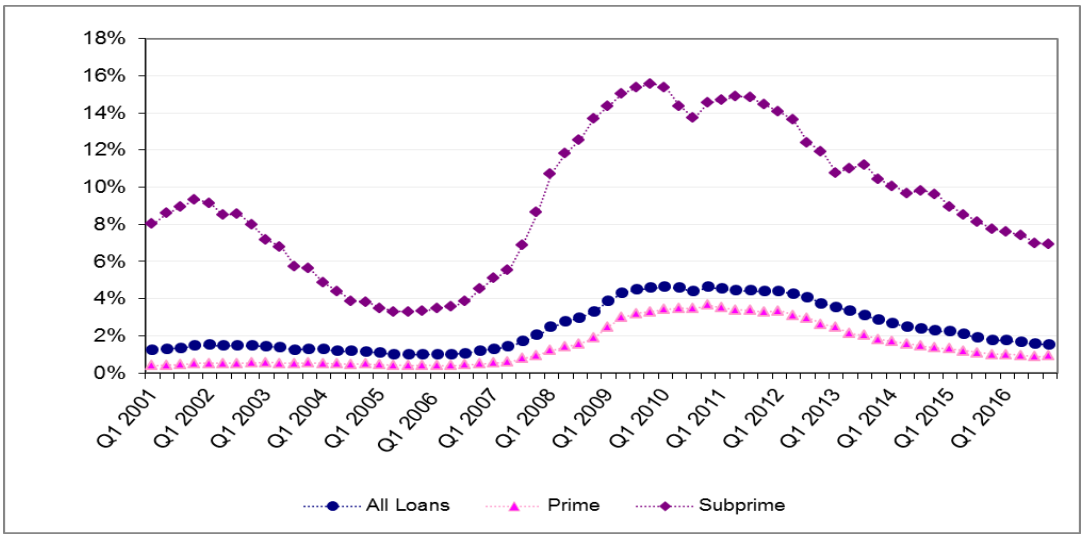
[1] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *An Analysis of Mortgage Refinancing, 2001-2003*, November 2004, pages 1 and 4, http://www.huduser.org/Publications/pdf/MortgageRefinance03.pdf.

[2] For example, see Chris Mayer and Karen Pence, *Subprime Mortgages: What, Where, and To Whom?*, Finance and Economics Discussion Series, Division of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington, DC, 2007, http://www.federalreserve.gov/pubs/feds/2008/200829/200829pap.pdf. The share of subprime mortgage originations depends, in part, on the definition of subprime lending and the data source used.

**Figure 1** illustrates the trends in the rates of all mortgages, subprime mortgages, and prime mortgages in the foreclosure process between 2001 and 2016.

**Figure 1. Percentage of Mortgages in the Foreclosure Process**

Q1 2001-Q4 2016




**Source:** Figure created by CRS using data from the Mortgage Bankers Association.

**Notes:** The Mortgage Bankers Association (MBA) is one of several organizations that reports delinquency and foreclosure data. MBA estimates that its data cover between 80% and 90% of outstanding first-lien mortgages on single-family properties.

The foreclosure rate for subprime loans has always been higher than the foreclosure rate for prime loans. For example, in the second quarter of 2006, just over 3.5% of subprime loans were in the foreclosure process compared to less than 0.5% of prime loans. However, both prime and subprime loans saw increases in foreclosure rates in the years following 2006. Like the foreclosure rate for all loans combined, the foreclosure rates for prime and subprime loans both more than quadrupled after 2006, with the rate of subprime loans in the foreclosure process increasing to over 15.5% in the fourth quarter of 2009 and the rate of prime loans in the foreclosure process increasing to more than 3% over the same time period. As of the fourth quarter of 2016, the rate of subprime loans in the foreclosure process was just under 7%, while the rate of prime loans in the foreclosure process was less than 1%.

In addition to mortgages that were in the foreclosure process, an additional 1.6% of all mortgages were 90 or more days delinquent but not yet in foreclosure in the fourth quarter of 2016. These are mortgages that are in default, but for one reason or another, the mortgage servicer has not started the foreclosure process yet. Such reasons could include the volume of delinquent loans that the servicer is handling, delays due to efforts to modify the mortgage before beginning foreclosure, or voluntary pauses in foreclosure activity put in place by the servicer. Considering mortgages that are 90 or more days delinquent but not yet in foreclosure, as well as mortgages that are actively in the foreclosure process, may give a more complete picture of the number of mortgages that are in danger of ultimately resulting in foreclosure completions.

## Impacts of Foreclosure

Losing a home to foreclosure can have a number of negative effects on a household. For many families, losing a home can mean losing the household's largest store of wealth. Furthermore,

foreclosure can negatively impact a borrower's creditworthiness, making it more difficult for him or her to buy a home in the future. Finally, losing a home to foreclosure can also mean that a household loses many of the less tangible benefits of owning a home. Research has shown that these benefits might include increased civic engagement that results from having a stake in the community, and better health, school, and behavioral outcomes for children.[3]

Some homeowners might have difficulty finding a place to live after losing their homes to foreclosure. Many will become renters. However, some landlords may be unwilling to rent to families whose credit has been damaged by foreclosure, limiting the options open to these families. There can also be spillover effects from foreclosures on current renters. Renters living in buildings where the landlord is facing foreclosure may be required to move, sometimes on very short notice, even if they are current on their rent payments.[4] As more homeowners become renters and as more current renters are displaced when their landlords face foreclosure, pressure on local rental markets may increase, and more families may have difficulty finding affordable rental housing. Some observers have also raised the concern that high numbers of foreclosures can contribute to homelessness, either because families who lose their homes have trouble finding new places to live or because the increased demand for rental housing makes it more difficult for families to find adequate, affordable units. However, researchers have noted that a lack of data makes it difficult to measure the extent to which foreclosures contribute to homelessness.[5]

If foreclosures are concentrated, they can also have negative impacts on communities. Many foreclosures in a single neighborhood may depress surrounding home values.[6] If foreclosed homes stand vacant for long periods of time, they can attract crime and blight, especially if they are not well-maintained. Concentrated foreclosures also place pressure on local governments, which can lose property tax revenue and may have to step in to maintain vacant foreclosed properties.

## Why Might a Household Find Itself Facing Foreclosure?

There are many reasons that a household might become delinquent on its mortgage payments. Some borrowers may have simply taken out loans on homes that they could not afford. However, many homeowners who believed they were acting responsibly when they took out a mortgage nonetheless find themselves facing foreclosure. Factors that can contribute to a household having

[3] For example, see Donald R. Haurin, Toby L. Parcel, and R. Jean Haurin, *The Impact of Homeownership on Child Outcomes*, Joint Center for Housing Studies, Harvard University, Low-Income Homeownership Working Paper Series, October 2001, http://www.jchs.harvard.edu/research/publications/impact-homeownership-child-outcomes, and Denise DiPasquale and Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, National Bureau of Economic Research, NBER Working Paper 6363, Cambridge, MA, January 1998, http://www.nber.org/papers/w6363.pdf?new_window=1.

[4] In 2009, Congress passed the Protecting Tenants at Foreclosure Act (PTFA), a temporary measure to provide certain federal protections for renters living in foreclosed properties. The law required that most tenants be given at least 90 days' notice before being evicted, and in some cases allowed tenants to remain for the terms of their lease. The PTFA was enacted as Title VII of Division A of the Helping Families Save Their Homes Act (P.L. 111-22) and expired on December 31, 2014.

[5] For example, see the Institute for Children, Poverty, and Homelessness, "Foreclosures and Homelessness: Understanding the Connection," January 2013, http://www.icphusa.org/filelibrary/ICPH_policybrief_ForeclosuresandHomelessness.pdf.

[6] For a review of the literature on the impact of foreclosures on nearby house prices, see Kai-yan Lee, *Foreclosure's Price-Depressing Spillover Effects on Local Properties: A Literature Review*, Federal Reserve Bank of Boston, Community Affairs Discussion Paper, No. 2008-01, September 2008, http://www.bos.frb.org/commdev/pcadp/2008/pcadp0801.pdf.

difficulty making its mortgage payments include changes in personal circumstances, which can be exacerbated by macroeconomic conditions, and features of the mortgages themselves.

## Changes in Household Circumstances

Changes in a household's circumstances can affect its ability to pay its mortgage. For example, a number of events can leave a household with a lower income than it anticipated when it bought its home. Such changes in circumstances can include a lost job, an illness, or a change in family structure due to divorce or death. Families that expected to maintain a certain level of income may struggle to make payments if a household member loses a job or faces a cut in pay, or if a two-earner household becomes a single-earner household. Unexpected medical bills or other unforeseen expenses can also make it difficult for a family to stay current on its mortgage.

Furthermore, sometimes a change in circumstances means that a home no longer meets a family's needs, and the household needs to sell the home. These changes can include having to relocate for a job or needing a bigger house to accommodate a new child or an aging parent. Traditionally, households that needed to move, or who experienced a decline in income, could usually sell their existing homes. However, the home price declines in many communities nationwide left many households in a negative equity position, or "underwater," meaning that they owed more on their mortgages than the houses were currently worth.[7] This limits homeowners' ability to sell their homes for enough money to pay off their mortgages if they have to move; many of these families are effectively trapped in their current homes and mortgages because they cannot afford to sell their homes at a loss.

The risks presented by changing personal circumstances have always existed for anyone who took out a loan, but deteriorating macroeconomic conditions in the years following 2006, such as falling home prices and increasing unemployment, made families especially vulnerable to losing their homes for such reasons. The fall in home values that left some homeowners owing more than the value of their homes made it difficult for homeowners to sell their homes in order to avoid a foreclosure if they experienced a change in circumstances, and it may have increased the incentive for homeowners to walk away from their homes if they could no longer afford their mortgage payments. Along with the fall in home values, another macroeconomic trend accompanying the increase in foreclosures was high unemployment. More households experiencing job loss and the resultant income loss made it difficult for many families to keep up with their monthly mortgage payments.

## Mortgage Features

Borrowers might also find themselves having difficulty staying current on their loan payments due in part to features of their mortgages. In the years preceding the sharp increase in foreclosure rates, there had been an increase in the use of alternative mortgage products whose terms differ significantly from the traditional 30-year, fixed interest rate mortgage model.[8] While borrowers with traditional mortgages are not immune to delinquency and foreclosure, many of these alternative mortgage features seem to have increased the risk that a homeowner might have

[7] According to CoreLogic, a real estate analytics firm, negative equity peaked in the fourth quarter of 2011, when over 12 million properties, or a quarter of homes with mortgages, were in negative equity positions. As of the fourth quarter of 2016, rising home prices had helped many households regain positive equity, but over 6% of homes with mortgages, or over 3 million properties, remained in negative equity positions. See CoreLogic, *Equity Report Fourth Quarter 2016*, p. 9, http://www.corelogic.com/research/negative-equity/equity-report-q4-2016-screen-030817.pdf.

[8] For example, see Government Accountability Office, *Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved*, testimony, September 20, 2006, http://gao.gov/assets/120/114847.pdf.

trouble staying current on his or her mortgage. Many of these loans were structured to have low monthly payments in the early stages and then adjust to higher monthly payments depending on prevailing market interest rates and/or the length of time the borrower held the mortgage. Furthermore, many of these mortgage features made it more difficult for homeowners to quickly build equity in their homes. Some examples of the features of these alternative mortgage products are listed below.

- **Adjustable Rate Mortgages (ARMs):** With an adjustable-rate mortgage, a borrower's interest rate can change at predetermined intervals, often based on changes in an index. The new interest rate can be higher or lower than the initial interest rate, and monthly payments can also be higher or lower based on both the new interest rate and any interest rate or payment caps.[9] Some ARMs also include an initial low interest rate known as a teaser rate. After the initial low-interest period ends and the new interest rate kicks in, the monthly payments that the borrower must make may increase, possibly by a significant amount.

  ARMs make financial sense for some borrowers, especially if interest rates are expected to stay the same or go down in the future or if the gap between short-term and long-term rates gets very wide (the interest rate on ARMs tends to follow short-term interest rates in the economy). The lower initial interest rate on ARMs can help people own a home sooner than they may have been able to otherwise, or can make sense for borrowers who cannot afford a high loan payment in the present but expect a significant increase in income in the future that would allow them to afford higher monthly payments. Further, in markets with rising property values, borrowers with ARMs may be able to refinance their mortgages before the mortgage resets in order to avoid higher interest rates or large increases in monthly payments. However, ARMs can become problematic if borrowers are not prepared for increases in monthly payments that can accompany higher interest rates. If home prices fall, refinancing the mortgage or selling the home to pay off the debt may not be feasible, leaving the homeowner with higher mortgage payments if interest rates rise.
- **Zero- or Low-Down-Payment Loans:** As the name suggests, zero-down-payment and low-down-payment loans require either no down payment or a significantly lower down payment than has traditionally been required. These types of loans can make it easier for certain creditworthy homebuyers who do not have the funds to make a large down payment to purchase a home. This type of loan may be especially useful in areas where home prices are rising more rapidly than income, because it allows borrowers without enough cash for a large down payment to enter markets they could not otherwise afford. However, a low- or no-down-payment loan also means that families have little or no equity in their homes in the early phases of the mortgage, making it difficult to sell the home or refinance the mortgage in response to a change in circumstances if home prices are not increasing. Such loans may also mean that a homeowner takes out a larger mortgage than he or she would otherwise.

[9] Even if the interest rate remains the same or decreases, it is possible for monthly payments to increase if prior payments were subject to an interest rate cap or a payment cap. This is because unpaid interest that would have accrued if not for the cap can be added to the principal loan amount, resulting in negative amortization. For more information on the many variations of adjustable rate mortgages, see The Federal Reserve Board, *Consumer Handbook on Adjustable Rate Mortgages*, http://www.federalreserve.gov/pubs/arms/arms_english.htm#drop.

- **Interest-Only Loans:** With an interest-only loan, borrowers pay only the interest on a mortgage—but no part of the principal—for a set period of time. This option increases the homeowner's monthly payments in the future, after the interest-only period ends and the principal amortizes. These types of loans limit a household's ability to build equity in the home, making it difficult to sell or refinance the home in response to a change in circumstances if home prices are not increasing.
- **Negative Amortization Loans:** With a negative amortization loan, borrowers have the option to pay less than the full amount of the interest due for a set period of time. The loan "negatively amortizes" as the remaining interest is added to the outstanding loan balance. Like interest-only loans, this option increases future monthly mortgage payments when the principal and the balance of the interest amortizes. These types of loans can be useful in markets where property values are rising rapidly, because borrowers can enter the market and then use the equity gained from rising home prices to refinance into loans with better terms before payments increase. They can also make sense for borrowers who currently have low incomes but expect a significant increase in income in the future. However, when home prices stagnate or fall, interest-only loans and negative amortization loans can leave borrowers with negative equity, making it difficult to refinance or sell the home to pay the mortgage debt.
- **Low- or No-Documentation Loans:** As the name suggests, these types of loans do not require the full range of income and asset documentation that is usually required to obtain a mortgage. Traditionally, these types of loans were made to borrowers with good credit scores and, usually, high incomes or large amounts of personal wealth, but they began to be used more widely in the years preceding the increase in foreclosure rates. Low- or no-documentation loans may be useful for borrowers with income that is difficult to document, such as those who are self-employed or work on commission. However, because a lender does not have full income information, these loans may not be underwritten as rigorously as other types of mortgages. Furthermore, they have the potential to allow for more fraudulent activity on the part of both borrowers and lenders.

While all of these types of loans can make sense for certain borrowers in certain circumstances, many of these loan features began to be used more widely and may have played a role in the increase in foreclosure rates. Some homeowners were current on their mortgages before their monthly payments increased due to interest rate resets or the end of option periods. Some built up little equity in their homes because they were not paying down the principal balance of their loan or because they had not made a down payment. Borrowers without sufficient equity find it difficult to take advantage of options such as refinancing into a more traditional mortgage if monthly payments become too high or selling the home if their personal circumstances change. Stagnant or falling home prices in many regions also hampered borrowers' ability to build equity in their homes, and mortgage payment increases combined with house price declines resulted in limited options for some troubled borrowers.

## Types of Loan Workouts

When a household falls behind on its mortgage, there are options that lenders or mortgage servicers may be able to employ as an alternative to beginning foreclosure proceedings. Some of

these options, such as a short sale and a deed-in-lieu of foreclosure,[10] allow a homeowner to avoid the foreclosure process but still result in a household losing its home. This section describes methods of avoiding foreclosure that allow homeowners to keep their homes; these options generally take the form of repayment plans or loan modifications.

Many types of loan modifications, in particular, are costly for lenders or mortgage investors because they generally reduce the amount that is repaid—either through reducing principal or interest payments—or change the timing of the repayment. However, foreclosure is also costly for lenders or mortgage investors; there are costs associated with the foreclosure process itself, and the sales price of a foreclosure is generally less than the amount that was owed on the mortgage. Therefore, in some circumstances, loan modifications may be less costly than a foreclosure.

## Repayment Plans

A repayment plan allows a delinquent borrower to regain current status on his loan by paying back the payments he or she has missed, along with any accrued late fees. This is different from a loan modification, which changes one or more of the terms of the loan (such as the interest rate). Under a repayment plan, the missed payments and late fees may be paid back after the rest of the loan is paid off, or they may be added to the existing monthly payments. The first option increases the time that it will take for a borrower to pay back the loan, but his or her monthly payments will remain the same. The second option results in an increase in monthly payments. Repayment plans may be a good option for homeowners who experienced a temporary loss of income but are now financially stable. However, since they do not generally make payments more affordable, repayment plans are unlikely to help homeowners with unaffordable loans avoid foreclosure in the long term.

## Interest Rate Reductions

One form of a loan modification is when the lender voluntarily lowers the interest rate on a mortgage. This is different from a refinance, in which a borrower takes out a new mortgage with a lower interest rate and uses the proceeds from the new loan to pay off the old loan. Unlike refinancing, a borrower does not have to pay closing costs or qualify for a new loan to get a mortgage modification with an interest rate reduction, which can make interest rate reductions a good option for troubled borrowers who owe more on their mortgages than their homes are worth. The interest rate can be reduced permanently, or it can be reduced for a period of time before increasing again to a certain fixed point. Lenders can also freeze interest rates at their current level in order to avoid impending interest rate resets on adjustable rate mortgages. Interest rate modifications are relatively costly to the lender or mortgage investor because they reduce the amount of interest income that the lender or investor will receive, but they can be effective at reducing monthly payments to a more affordable level.

## Extended Loan Term/Extended Amortization

Another type of loan modification that can lower monthly mortgage payments is extending the amount of time over which the loan is paid back. While extending the loan term increases the total cost of the mortgage for the borrower because more interest will accrue, it allows monthly

[10] In a short sale, a household sells its home for less than the amount it owes on its mortgage. Often, the mortgage holder will accept the proceeds from the sale as payment in full on the mortgage even though it is taking a loss. A deed-in-lieu of foreclosure refers to the practice of a borrower turning the deed to the house over to the lender, which accepts the deed as payment of the mortgage debt. However, in some cases, the borrower may still be liable for the remaining outstanding mortgage debt when a short sale or a deed-in-lieu is utilized.

payments to be smaller because they are paid over a longer period of time. Most mortgages in the United States have an initial loan term of 30 years; extending the loan term from 30 to 40 years, for example, could result in a lower monthly mortgage payment for the borrower.

### Principal Forbearance

Principal forbearance means that a lender or servicer removes part of the principal from the portion of the loan balance that is subject to interest, thereby lowering borrowers' monthly payments by reducing the amount of interest owed. The portion of the principal that is subject to forbearance still needs to be repaid by the borrower in full, usually after the interest-bearing part of the loan is paid off or when the home is sold. Because principal forbearance does not actually change any of the loan terms, it resembles a repayment plan more than a loan modification.

### Principal Forgiveness

Principal forgiveness, also called principal reduction or a principal write-down, is a type of mortgage modification that lowers borrowers' monthly payments by forgiving a portion of the loan's principal balance. The forgiven portion of the principal never needs to be repaid. Because the borrower now owes less, his or her monthly payment will be smaller. This option is costly for lenders or mortgage investors, but it can help borrowers achieve affordable monthly payments, as well as increase the equity that borrowers have in their homes and therefore potentially increase their desire to stay current on the mortgage and avoid foreclosure.[11]

## Federal Response to Increased Foreclosure Rates

As foreclosure rates began to increase rapidly in the years after 2006, there was broad bipartisan consensus that the rapid rise in foreclosures had negative consequences on households and communities.[12] However, there was less agreement among policymakers about how much the federal government should do to prevent foreclosures. Proponents of enacting government policies and using government resources to prevent foreclosures argued that, in addition to assisting households experiencing hardship, such action may prevent further damage to home

[11] Historically, one impediment to principal forgiveness has been that borrowers were required to claim the forgiven amount as income, and therefore had to pay taxes on that income. In December 2007, Congress passed legislation that temporarily excluded mortgage debt forgiven prior to January 1, 2010, from taxable income; the exclusion was subsequently extended several times, most recently to mortgage debt forgiven prior to January 1, 2017. For more information about the tax treatment of principal forgiveness, see CRS Report RL34212, *Analysis of the Tax Exclusion for Canceled Mortgage Debt Income*, by Mark P. Keightley and Erika K. Lunder.

[12] For example, in 2008, Representative Spencer Bachus, Ranking Member of the House Committee on Financial Services at the time, said that "[i]t is in everyone's best interest as a general rule to prevent foreclosures. Foreclosures are a negative impact not only on the family in that home but also their neighbors, their property values, the community, and the local government." (See U.S. Congress, House Committee on Financial Services, *Private Sector Cooperation with Mortgage Modifications—Ensuring that Investors, Servicers, and Lenders Provide Real Help for Troubled Homeowners*, 110th Cong., 2nd sess., November 12, 2008, Serial No. 110-144 (Washington: GPO, 2009), p. 5, https://www.gpo.gov/fdsys/pkg/CHRG-110hhrg46592/pdf/CHRG-110hhrg46592.pdf.) Similarly, Senator Chris Dodd, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs at the time, described an "overwhelming tide of foreclosures ravaging our neighborhoods and forcing thousands of American families from their homes." (See "Dodd Statement on Government Loan Modification Program," statement, November 12, 2008, http://www.banking.senate.gov/public/index.cfm/democratic-press-releases?ID=8505A8E5-EF0C-4480-8BBD-6A2E360DB44A.)

values and communities that can be caused by concentrated foreclosures. Supporters also suggested that preventing foreclosures could help stabilize the economy as a whole.

Opponents of government foreclosure prevention programs argued that foreclosure prevention should be worked out between lenders and borrowers without government interference. Opponents expressed concern that people who did not really need help, or who were not perceived to deserve help, could unfairly take advantage of government foreclosure prevention programs. They argued that taxpayers' money should not be used to help people who could still afford their loans but wanted to get more favorable mortgage terms, people who may be seeking to pass their losses on to the lender or the taxpayer, or people who knowingly took on mortgages that they could not afford.

Despite the concerns surrounding foreclosure prevention programs, and disagreement over the proper role of the government in preserving homeownership, the federal government implemented a variety of temporary initiatives to attempt to address the high rates of residential mortgage foreclosures.[13] Some of these initiatives were enacted by Congress, while others were created administratively by the George W. Bush and Obama Administrations. Several of these initiatives remained active through at least 2016, including the following:

- the Home Affordable Modification Program (HAMP), which provided financial incentives to mortgage servicers to modify certain mortgages;
- the Home Affordable Refinance Program (HARP), which allows certain homeowners with little or no equity in their homes to refinance their mortgages;
- the Hardest Hit Fund, which provides funding to certain states to use for locally tailored foreclosure prevention programs;
- the FHA Short Refinance Program, which allowed certain borrowers to refinance their mortgages into new loans insured by the Federal Housing Administration (FHA) while reducing the principal amount of the loan; and
- additional funding for housing counseling to assist people in danger of foreclosure.

In addition to federal efforts to address mortgage foreclosures, many state and local governments also implemented a range of initiatives to reduce the number of foreclosures in recent years. The private sector also pursued foreclosure prevention efforts, including creating the HOPE NOW Alliance, a voluntary alliance of mortgage servicers, lenders, investors, counseling agencies, and others that formed in October 2007 with the encouragement of the federal government to engage in active outreach efforts to troubled borrowers.[14] While many private lenders and mortgage servicers participate in federal foreclosure prevention initiatives, many also have their own programs or procedures in place to work with borrowers who are having difficulty making their

[13] This report describes broad federal programs intended to assist troubled borrowers and reduce foreclosures. There were also additional efforts to prevent unnecessary foreclosures, including amendments to the Servicemembers Civil Relief Act to extend temporary foreclosure protections for servicemembers; legal settlements between the federal government and banks that, in part, directed funding towards homeowners affected by foreclosures; administrative changes by federal housing agencies (like the Federal Housing Administration) and the government-sponsored enterprises Fannie Mae and Freddie Mac related to loss mitigation procedures for loans that they back; and rules promulgated by the Consumer Financial Protection Bureau (CFPB) to establish national standards for mortgage servicers, including standards related to how they service troubled mortgages. These efforts are not included in this report.

[14] For a list of members of the HOPE NOW Alliance, see the HOPE NOW website at https://www.hopenow.com/members.php.

mortgage payments. This report focuses on federal efforts to prevent foreclosure, and does not address these state, local, and private sector efforts.

The following sections describe federal foreclosure prevention initiatives that remained active through at least 2016. The **Appendix** describes certain additional federal foreclosure prevention initiatives that were implemented in response to the increase in foreclosure rates but ended prior to 2016.

# Home Affordable Modification Program (HAMP)

On February 18, 2009, President Obama announced the Making Home Affordable (MHA) initiative.[15] Making Home Affordable included separate programs to (1) help certain troubled borrowers obtain affordable loan modifications and (2) make it easier for certain homeowners with little or no equity in their homes to refinance their mortgages. These initiatives were known as the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP), respectively. This section describes HAMP, while a later section describes HARP.[16]

The deadline to apply for HAMP was December 30, 2016.[17] In the past, Treasury extended the program expiration date multiple times,[18] but the Consolidated Appropriations Act, 2016 (P.L. 114-113) put the December 31, 2016, expiration date in statute.[19] HAMP applications received prior to December 30, 2016, can still be considered for modifications, and modifications that have already been made through HAMP remain in effect.

HAMP was primarily administered by the Department of the Treasury. Fannie Mae and Freddie Mac each issued their own HAMP requirements for the mortgages that they owned or guaranteed.[20]

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[15] The program details originally referred to the program as the Homeowner Affordability and Stability Plan, or HASP. Further program details released on March 4, 2009, began referring to the plan as Making Home Affordable. More information on Making Home Affordable can be found http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/default.aspx.

[16] HAMP shared some features of earlier foreclosure prevention programs, such as Fannie Mae's and Freddie Mac's Streamlined Modification Program and the Federal Deposit Insurance Corporation's plan to modify loans held by the failed IndyMac Bank. These programs are described in the Appendix.

[17] During the 112th Congress, the House passed H.R. 839, which, if enacted, would have terminated the program and rescinded unobligated funds. Borrowers who were currently participating in the program would not have been affected if this bill had become law. CBO estimated that H.R. 839 would have reduced direct federal spending by $1.4 billion over a 10-year period. (See Congressional Budget Office, *H.R. 839 HAMP Termination Act of 2011*, cost estimate, March 11, 2011, http://cbo.gov/ftpdocs/120xx/doc12097/hr839.pdf.) The bill was not considered by the Senate.

[18] The program was originally scheduled to end on December 31, 2012. However, in January 2012 the Administration announced that it would extend the deadline to December 31, 2013; in May 2013 the Administration announced that it would extend the program until December 31, 2015; and in June 2014 the Administration announced that it would extend the program until at least December 31, 2016. See press releases from Treasury and HUD announcing the extensions at http://www.treasury.gov/connect/blog/Pages/Expanding-our-efforts-to-help-more-homeowners-and-strengthen-hard-hit-communities.aspx, http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2013/HUDNo.13-083, and http://www.treasury.gov/press-center/press-releases/Pages/jl2444.aspx.

[19] Section 709 of P.L. 114-113

[20] Treasury's requirements governing HAMP for mortgages that are not backed by Fannie Mae or Freddie Mac are available in a handbook that was updated periodically to incorporate new guidance or changes to the program. That handbook is available at https://www.hmpadmin.com/portal/index.jsp. HAMP guidance related to mortgages owned or guaranteed by Fannie Mae or Freddie Mac can be found on those entities' respective websites. In general, the HAMP

## Program Description

Through HAMP, the government provided financial incentives to participating mortgage servicers who modified eligible troubled borrowers' mortgages in order to reduce the borrowers' monthly mortgage payments to no more than 31% of their monthly income. HAMP was voluntary for mortgage servicers,[21] but once a servicer signed an agreement with Treasury to participate in the program, that servicer was bound by the rules of the program and was required to modify eligible mortgages that it serviced according to the program guidelines.

For mortgages that were modified under HAMP, servicers reduced borrowers' payments by reducing the interest rate, extending the loan term, and forbearing principal, in that order, as necessary to reach the target payment ratio of 31% of monthly income. (Servicers were permitted to reduce mortgage principal as part of a HAMP modification, but were not required to do so.) Servicers could reduce interest rates to as low as 2%. The new interest rate is required to remain in place for five years; after five years, if the interest rate is below the market rate at the time the modification agreement was completed, the interest rate can rise by one percentage point per year until it reaches that market rate. (For more information on these interest rate adjustments, see the "Interest Rate Adjustments" subsection later in this report.) Borrowers were required to make modified payments on time during a three-month trial period before the modification could be converted to permanent status.

The government provides financial incentives to servicers, investors, and borrowers for participation. Although the deadline to apply for HAMP has passed, Treasury can continue to pay incentives related to existing modifications (or modifications on mortgages where the application was received prior to the deadline) for several years into the future.

- Servicers received an upfront incentive payment for each successful permanent loan modification and can receive a "pay-for-success" payment for up to three years if the borrower remains current after the modification and the mortgage payment was reduced by at least 6%.
- The borrower can also receive a "pay-for-success" incentive payment (in the form of principal reduction) for up to five years if he or she remains current on the mortgage after the modification is finalized, as well as an additional principal reduction payment at the end of the sixth year after modification if the loan is in good standing.
- Investors received a payment cost-share incentive: after the investor bore the cost of reducing the monthly payment to 38% of monthly income, the government paid half the cost of further reducing the monthly mortgage payment from 38% to 31% of monthly income. Investors could also receive incentive payments for loans modified before a borrower became delinquent and for modifications in areas with declining home prices ("Home Price Decline Protection" incentives),

guidance for Fannie Mae and Freddie Mac mortgages was broadly similar to the guidance for other mortgages, but there were some differences.

[21] Servicers of mortgages backed by Fannie Mae or Freddie Mac were required to participate in HAMP for those mortgages. Companies that received funding through Troubled Asset Relief Program (TARP) or Financial Stability Plan (FSP) programs announced after the announcement of Making Home Affordable were also required to participate in HAMP. A list of participating servicers is available at https://www.makinghomeaffordable.gov/get-answers/pages/get-answers-how-contact-mortgage-company.aspx.

provided that the borrower's monthly mortgage payment was reduced by at least 6%.[22]

Treasury made a number of changes to the rules governing HAMP in the years after the program was introduced. Some of these changes were relatively minor, while others were more significant. Treasury communicated changes to the HAMP requirements to servicers in documents called Supplemental Directives.[23] In addition, Treasury implemented several additional HAMP-related programs to attempt to assist certain groups, such as unemployed borrowers or borrowers with negative equity, which are described in the "Related HAMP Programs" section of this report.

## Basic Eligibility Criteria

Borrowers seeking a HAMP modification applied through their mortgage servicer. The requirements governing HAMP were complex, and a number of factors could impact whether or not a specific borrower qualified for the program. However, there were several basic eligibility criteria that a borrower had to meet in order to qualify for a standard HAMP modification, including the following:

- a borrower had to have a mortgage on a single-family (one-to-four unit) property that was originated on or before January 1, 2009,
- the borrower had to live in the home as his or her primary residence (this criterion did not necessarily have to be met to qualify for a certain type of HAMP modification called "HAMP Tier 2," described further below),
- the unpaid principal balance on the mortgage could not be greater than $729,750 for a one-unit property,
- the borrower had to be paying more than 31% of his monthly gross income toward mortgage payments,
- the borrower had to be experiencing a financial hardship that made it difficult to remain current on the mortgage. Borrowers did not need to already be in default on their mortgages in order to qualify, but default had to be "reasonably foreseeable," and
- the estimated net present value of a modification had to result in greater value for the mortgage investor than the net present value of pursuing a foreclosure (this "net present value test" is described in more detail below).

More detailed eligibility criteria and program requirements were included in Treasury's *Making Home Affordable Handbook* and related policy directives.[24] Treasury's requirements governed mortgages that were not backed by Fannie Mae and Freddie Mac; Fannie and Freddie issued their own program requirements for the mortgages that they owned or guaranteed.

[22] Incentive payments and how they are calculated are described in Treasury's *Making Home Affordable Handbook*, Chapter II, Section 13.

[23] Archived Supplemental Directives, which have since been incorporated into the *Making Home Affordable Handbook*, are available at https://www.hmpadmin.com/portal/programs/guidance.jsp.

[24] The Making Home Affordable Handbook and associated policy directives (called "Supplemental Directives") can be found at https://www.hmpadmin.com/portal/programs/hamp.jsp#1. The handbook contains the requirements for mortgages that are not backed by Fannie Mae or Freddie Mac. Guidance for mortgages backed by Fannie Mae and Freddie Mac can be found on their respective websites.

Servicers participating in HAMP conducted a "net present value test" (NPV test) on eligible mortgages that compared the expected financial returns to investors from doing a loan modification to the expected financial returns from pursuing a foreclosure.[25] If the expected returns from a loan modification were greater than those from foreclosure, servicers were required to reduce borrowers' payments to no more than 38% of monthly income. The government then shared half the cost of reducing borrowers' payments from 38% of monthly income to 31% of monthly income. Servicers were not required to modify mortgages with negative net present value results.

## HAMP Tier 2 Eligibility

In early 2012, Treasury announced an expanded version of HAMP, referred to as HAMP Tier 2, for some borrowers who were not eligible for a standard HAMP modification.[26] HAMP Tier 2 represented an alternative to the standard HAMP modification (thereafter referred to as HAMP Tier 1), rather than a replacement of the standard HAMP modification.

Under HAMP Tier 2, borrowers still had to meet many of the basic HAMP eligibility criteria, including having a mortgage on a single-family property that was originated on or before January 1, 2009, experiencing a documented hardship, and having an unpaid principal balance below specified thresholds. However, borrowers might have been able to qualify even if they did not meet other requirements to qualify for a standard HAMP modification, such as if they had a mortgage payment-to-income ratio that was already below 31% or if they did not live in the home as a primary residence. In order for a mortgage secured by a rental property to be eligible for HAMP Tier 2, the borrower had to be delinquent on the mortgage (mortgages in "imminent default" were not eligible), the property had to be currently occupied by a tenant or be vacant, and the borrower had to certify that he or she intended to rent the property for at least five years (although at any point in that five-year period the borrower could sell the home or choose to occupy it as a principal residence).

In addition to the eligibility requirements being different for HAMP Tier 2, the way in which servicers modified mortgages and the incentive payment structure also differed. Only mortgages that were not backed by Fannie Mae or Freddie Mac were eligible for HAMP Tier 2.[27]

[25] Servicers were allowed to use their own values for certain NPV inputs on the basis of their own portfolio experience, but such allowed changes were limited and had to be approved by Treasury. The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) required Treasury to make a net present value test available on the internet, based on Treasury's NPV methodology, to help borrowers better understand the NPV test and their potential results. Treasury was also required to include a disclaimer stating that specific servicers' NPV models may differ in some respects. The NPV calculator is available at https://checkmynpv.com/. The Dodd-Frank Act also required that servicers provide borrowers with certain NPV inputs upon denying the borrowers for HAMP modifications; this differed from Treasury's guidance at the time, in which borrowers had to ask servicers to see certain NPV inputs within a certain time period if the borrower was denied a modification due to a negative NPV result.

[26] Supplemental Directive 12-02, *Making Home Affordable Program – MHA Extension and Expansion*, March 9, 2012, https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1202.pdf.

[27] Although mortgages backed by Fannie Mae or Freddie Mac were not eligible for HAMP Tier 2, they may have been eligible for a similar modification called the GSE Standard Modification, developed by Fannie Mae and Freddie Mac as part of their Servicing Alignment Initiative started in October 2011. Information on Freddie Mac's Standard Modification is at http://www.freddiemac.com/singlefamily/service/standard_modification.html, and information on Fannie Mae's Standard Modification is at https://www.fanniemae.com/content/guide/servicing/d2/3.2/05.html.

## HAMP Funding

The Administration originally estimated that HAMP would cost $75 billion. Of this amount, $50 billion was to come from Troubled Asset Relief Program (TARP) funds,[28] and $25 billion was to come from Fannie Mae and Freddie Mac for the costs of modifying mortgages that those entities owned or guaranteed.[29]

Treasury later revised its estimate of the amount of TARP funds that would be used for HAMP, and used some of the $50 billion originally allocated to HAMP to help pay for other foreclosure-related programs (the Hardest Hit Fund and the FHA Refinance program, both described in later sections of this report). Ultimately, Treasury committed about $38 billion of TARP funds to its foreclosure prevention programs, rather than the initial $50 billion. Of this amount, nearly $28 billion was committed to HAMP and its related programs, $9.6 billion was committed to the Hardest Hit Fund, and just over $100 million was committed to the FHA Short Refinance Program.[30]

As of December 31, 2016, $16 billion of the $28 billion allocated for HAMP and its related programs had been disbursed.[31] In addition, another nearly $8 billion was committed for the payment of future financial incentives associated with existing modifications.[32] These amounts did not include any funds that might be committed in the future for modifications of mortgages where the borrower's application had been received prior to the December 30, 2016, application deadline, but where the modification had not yet been finalized.

## HAMP Results to Date

The Treasury Department releases quarterly reports detailing the program's progress.[33] These reports offer a variety of information, including the number of overall trial and permanent modifications made under HAMP and the number of each that are currently active, the number of trial and permanent modifications made by individual servicers, and the number of trial and permanent modifications underway in each state.[34] (As noted earlier, borrowers must successfully complete a three-month trial period before the modification is converted to permanent status.)

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[28] TARP was authorized by the Emergency Economic Stabilization Act of 2008 (P.L. 110-343). For more information on TARP, see CRS Report R41427, *Troubled Asset Relief Program (TARP): Implementation and Status*, by Baird Webel.

[29] Department of the Treasury, *Section 105(a) Troubled Assets Relief Program Report to Congress for the Period February 1, 2009 to February 28, 2009*, p. 1, available at http://www.financialstability.gov/docs/105CongressionalReports/105aReport_03062009.pdf.

[30] These amounts have changed over time. For example, Treasury originally committed just over $8 billion to the FHA Short Refinance Program. In response to lower-than-anticipated program participation, and therefore fewer defaults, Treasury reduced the amount committed to the program multiple times. Furthermore, the Consolidated Appropriations Act, 2016 (P.L. 114-113) allowed Treasury to transfer $2 billion in unused TARP funds to the Hardest Hit Fund. Treasury made this transfer, increasing the amount committed to the Hardest Hit Fund while simultaneously reducing the amount committed to HAMP.

[31] U.S. Department of the Treasury, Troubled Asset Relief Program, *Monthly Report to Congress December 2016*, January 10, 2017, p. 5, https://www.treasury.gov/initiatives/financial-stability/reports/Documents/2016.12%20December%20Monthly%20Report%20to%20Congress.pdf.

[32] Ibid., p. 3.

[33] Initially, Treasury published monthly HAMP performance reports. Beginning with the second quarter of 2014, the reports are published on a quarterly basis rather than a monthly basis. The last monthly report was published in May 2014.

[34] Treasury's HAMP performance reports can be found at http://www.treasury.gov/initiatives/financial-stability/reports/

The Administration originally estimated that HAMP could eventually help up to between 3 million and 4 million homeowners. As of the fourth quarter of 2016, about 1 million HAMP modifications were active. Of these, about 38,000 were active trial modifications and about 962,000 were active permanent modifications.[35] **Table 1** shows the total number of HAMP trial and permanent modifications that had started since the program began, along with the number of each that were currently active as of the fourth quarter of 2016.[36]

**Table 1. Number of HAMP Modifications**

As of the fourth quarter of 2016

| | Trial Modifications | Permanent Modifications | Total |
|---|---|---|---|
| All Started | 2,511,344 | 1,683,112 | N/A |
| Currently Active | 37,680 | 962,209 | 999,889 |

**Source:** *Making Home Affordable Program Performance Report through the Fourth Quarter of 2016*.

**Note:** Includes HAMP Tier 2 modifications.

According to Treasury, the median HAMP modification resulted in a decrease of nearly $500 per month in a borrower's monthly mortgage payment, prior to the impact of any future interest rate adjustments (discussed further in the "Interest Rate Adjustments" section).[37]

## Related HAMP Programs

Treasury also established a number of additional components or subprograms that operated under HAMP. These subprograms generally targeted certain perceived barriers to modifications and/or certain populations of borrowers. Like HAMP, the deadline to apply for these programs was generally December 30, 2016, or in some cases earlier.[38] The subprograms that operated under HAMP included the following:[39]

### Second Lien Modification Program (2MP)

Many borrowers have second mortgages on their homes. A mortgage involves a claim, or *lien*, on the property that gives the lender a security interest in the home in the event that the borrower does not repay the loan. The lien that secures a second mortgage is referred to as a "second lien" because it is second in priority after the lien that secures the first mortgage.

Second liens have the potential to make loan modifications more difficult because (1) modifying the first lien may not reduce households' total monthly mortgage payments to an affordable level

Pages/Making-Home-Affordable-Program-Performance-Report.aspx.

[35] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter of 2016*, p. 7, https://www.treasury.gov/initiatives/financial-stability/reports/Documents/MHA%20Quarterly%20Report%20Q4%202016_C.pdf.

[36] These numbers include HAMP Tier 2 modifications. HAMP Tier 2 went into effect in June 2012. According to Treasury, a total of about 226,000 HAMP Tier 2 trial modifications, and about 197,000 HAMP Tier 2 permanent modifications, had been started as of the fourth quarter of 2016. See U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter 2016*, pp. 6-7.

[37] U.S. Department of the Treasury, *Making Home Affordable Program Performance Report Through the Fourth Quarter of 2016*, p. 8.

[38] See Treasury's "MHA Program Sunset Overview: Training for Trusted Advisors," June 2016, https://www.hmpadmin.com/portal/learningcenter/advisors/docs/mhasunsetoverview_ta_presentation.pdf.

[39] All of these subprograms are described in detail in Treasury's *Making Home Affordable Handbook*.

if the second mortgage remains unmodified, and (2) holders of primary mortgages may be hesitant to modify the mortgage if the second mortgage holder does not agree to re-subordinate the second mortgage to the first mortgage or to modify the second mortgage as well.

The Second Lien Modification Program was aimed at addressing second liens on properties where the first mortgage was modified through HAMP. If the servicer of the second lien was participating in 2MP, then that servicer had to agree either to modify the second lien in accordance with program guidelines, or to extinguish the second lien entirely in exchange for a lump sum payment, when a borrower's first mortgage was modified under HAMP. (Servicers signed up to participate in 2MP separately from signing up to participate in HAMP.)

Participating servicers and investors could receive financial incentives for modifying or extinguishing second liens under 2MP, and borrowers who remain current on both their HAMP modification and 2MP modification can receive "pay-for-success" incentive payments for up to five years.

2MP was first announced in August 2009. Treasury reported that about 79,000 second-lien modifications were active under 2MP as of the fourth quarter of 2016.[40]

## Home Affordable Foreclosure Alternatives Program (HAFA)

Through the Home Affordable Foreclosure Alternatives (HAFA) program, when a borrower met the basic eligibility criteria for HAMP, but did not ultimately qualify for a modification, did not successfully complete the trial period, or defaulted on a HAMP modification, participating servicers could receive incentive payments for completing a short sale or a deed-in-lieu of foreclosure as an alternative to foreclosure.[41] Servicers could receive financial incentive payments for each short sale or deed-in-lieu that was successfully executed, and borrowers could receive financial incentive payments to help with relocation expenses. Investors could receive partial reimbursement if they agreed to share a portion of the proceeds of the short sale with any subordinate lienholders.[42] (The subordinate lienholders, in turn, had to release their liens on the property and waive all claims against the borrower for the unpaid balance of the subordinate mortgages.) In order to attempt to streamline the process of short sales and deeds-in-lieu of foreclosure under HAFA, Treasury provided standardized documentation and processes for participating servicers to use.

HAFA went into effect on April 5, 2010, although servicers had the option to begin implementing the program before this date. Treasury reported that about 454,000 HAFA transactions had been completed as of the fourth quarter of 2016.[43] Most of these transactions were short sales (390,000) rather than deeds-in-lieu of foreclosure (64,000).

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[40] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter of 2016*, p. 15.

[41] Short sales and deeds-in-lieu are described in footnote 10. Under HAFA, the lender must agree to accept the proceeds of the short sale or the deed and property as full payment of the mortgage debt, and may not pursue borrowers for any remaining amounts owed on the mortgage. Short sales and deeds-in-lieu have a negative impact on a borrower's credit, but they may result in fewer negative consequences overall for the borrower than a foreclosure.

[42] Supplemental Directive 12-07, "Home Affordable Foreclosure Alternatives Program – Policy Update," November 1, 2012, p. 8, https://www.hmpadmin.com/portal/programs/docs/hafa/sd1207.pdf.

[43] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter of 2016*, p. 16.

## Home Affordable Unemployment Program (UP)

The Home Affordable Unemployment Program (UP) targeted borrowers who were unemployed. Under UP, participating servicers were required to offer forbearance periods to unemployed borrowers who applied for HAMP and met the UP eligibility criteria before evaluating those borrowers for HAMP. The forbearance period lasted for a minimum of 12 months, or until the borrower became re-employed, whichever occurred sooner.[44] Borrowers' mortgage payments were lowered to 31% or less of their monthly income through principal forbearance during this time period.

After the forbearance period ended, some borrowers may have regained employment and not needed further assistance. Other borrowers, such as those who were re-employed but at a lower salary, may have been able to qualify for a regular HAMP modification. Still other borrowers may have qualified for a foreclosure alternative such as a short sale or a deed-in-lieu of foreclosure, and some borrowers ultimately may not have been able to avoid foreclosure.

UP went into effect on July 1, 2010, although servicers could choose to implement the program earlier.[45] Treasury reported that about 46,000 UP forbearance plans had been started as of the fourth quarter of 2016.[46]

## Principal Reduction Alternative (PRA)

Under the Principal Reduction Alternative (PRA), participating servicers were required to consider reducing principal balances as part of HAMP modifications for homeowners who owed at least 115% of the value of their home. This applied to mortgages that were not backed by Fannie Mae and Freddie Mac. Fannie's and Freddie's regulator, the Federal Housing Finance Agency (FHFA), generally does not allow principal reduction for mortgages that Fannie Mae or Freddie Mac own or guarantee. (See the "Debate Over the Use of Principal Reduction in Mortgage Modifications" section later in this report for more information on Fannie Mae, Freddie Mac, and principal reduction.)

Under PRA, servicers ran two net present value tests for borrowers who owed at least 115% of the value of their homes: the first was the standard NPV test, and the second included principal reduction. If the net present value of the modification was higher under the test that included principal reduction, servicers had the option to reduce principal. However, they were not required to do so. If the principal was reduced, the amount of the principal reduction was initially treated as principal forbearance; the forbearance amount would be forgiven in three equal amounts over three years as long as the borrower remained current on his or her mortgage payments. Treasury offered additional financial incentives to investors when principal was reduced under PRA.

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[44] Originally, the forbearance period was 3 months. Treasury extended it to 12 months in Supplemental Directive 11-07, *Making Home Affordable Program – Expansion of Unemployment Forbearance*, July 25, 2011, available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1107.pdf. The change became effective on October 1, 2011.

[45] The original detailed guidelines on the Home Affordable Unemployment Program were released in Supplemental Directive 10-04 on May 11, 2010. These guidelines are available at https://www.hmpadmin.com/portal/docs/hamp_servicer/sd1004.pdf. Updated guidance can be found in Treasury's Making Home Affordable Handbook, available at https://www.hmpadmin.com/portal/index.jsp.

[46] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter of 2016*, p. 17.

The PRA went into effect on October 1, 2010.[47] According to Treasury, about 164,000 permanent PRA modifications were active as of the fourth quarter of 2016. In addition, there were about 37,000 active HAMP modifications that included principal reduction outside of PRA.[48]

## Selected HAMP Issues

In the years after HAMP was created, a number of concerns were raised related to its implementation and effectiveness.[49] This section briefly discusses three issues that were raised: interest rate adjustments on HAMP modifications; conversions of trial modifications to permanent status; and assessments of mortgage servicers' performance in implementing HAMP.

### Interest Rate Adjustments

Under HAMP, one of the ways in which mortgages were modified to achieve a 31% mortgage payment-to-income ratio was by reducing the interest rate on the mortgage to as low as 2%. The modified interest rate remains in effect for five years from the date of the modification, at which point the interest rate can rise by up to one percentage point per year until it reaches the market interest rate that was in effect at the time of the modification. For example, say a borrower had an interest rate of 6% on his original mortgage, that the interest rate was reduced to 3% under a modification, and that the market interest rate in effect at the time of the modification was 4.5%. After five years, the modified interest rate would increase to 4% from 3%, and the year after that it would increase to 4.5% from 4%. At that point there would be no further interest rate increases for this particular borrower. (Average market interest rates fluctuate over the course of a year, but the average annual interest rates for the years between 2009 and 2016 range from under 4% to just over 5%.)[50]

The first interest rate increases began in the later quarters of 2014. Treasury estimates that 80% of borrowers who received a standard HAMP modification (i.e., not a "Tier 2" modification) will experience interest rate increases, with a median total monthly payment increase of just over $200 after all of the interest rate increases go into effect.[51] However, expected average payment increases vary by state.[52]

Some housing advocates have expressed concerns that the interest rate increases and resulting payment increases could make it difficult for some borrowers to continue making their mortgage payments. In December 2014, Treasury announced that homeowners who remain current on their payments under HAMP through six years will be eligible for an additional financial incentive of

[47] Detailed guidelines on the Principal Reduction Alternative were released in Supplemental Directive 10-05 on June 3, 2010. These guidelines are available at https://www.hmpadmin.com/portal/docs/hamp_servicer/sd1005.pdf.

[48] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter of 2016*, p. 14.

[49] The Special Inspector General for the Troubled Asset Relief Program (SIGTARP) is one entity that has examined various issues related to HAMP. SIGTARP's quarterly reports on the progress of TARP programs, including HAMP, are available at https://www.sigtarp.gov/pages/quarterly.aspx, and other SIGTARP audit reports are at https://www.sigtarp.gov/pages/audit.aspx.

[50] See Freddie Mac's historical monthly data for 30-year fixed rate mortgages at http://www.freddiemac.com/pmms/pmms_archives.html.

[51] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through the Fourth Quarter of 2016*, p. 9.

[52] U.S. Department of the Treasury, *Making Home Affordable Program Performance Report through the Fourth Quarter of 2016*, pp. 36-37.

$5,000 in the form of principal reduction. (Borrowers were already eligible for up to $1,000 per year in the form of principal reduction for each of the first five years of the modification if they remained current on their modified mortgages.) The additional financial incentive may, in part, be intended to mitigate the impact of the interest rate increases on borrowers.

## Conversion of Trial Modifications to Permanent Status

After HAMP had been in place for several months, many observers began to express concern at the high number of trial modifications that were being canceled rather than converting to permanent status and the length of time that it was taking for trial modifications to become permanent. In response to these concerns, Treasury took a number of steps to attempt to facilitate the conversion of trial modifications to permanent modifications, including outreach efforts to borrowers to help them understand and meet the program's documentation requirements and increased reporting requirements and monitoring of servicers.[53] Most notably, since June 1, 2010, Treasury has required servicers to have documented income information from borrowers before offering a trial modification and to verify that information before a borrower can be approved for a trial period plan.[54]

Prior to June 2010, Treasury had allowed servicers to approve borrowers for trial modifications on the basis of stated income information in order to get trial modifications started more quickly, but the servicers had to verify this information before a modification could become permanent. In cases where the borrowers' stated income information differed from the documented information, servicers often had to re-evaluate borrowers for the program (for example, by running a new NPV test), which sometimes took additional time or resulted in borrowers who had been approved for a trial modification being denied for a permanent modification.

Requiring verified information before a trial modification could begin was expected to result in more trial modifications converting to permanent modifications going forward. As of the fourth quarter of 2016, Treasury reported that about 116,000 trial modifications had been canceled since the requirement for servicers to verify income upfront had gone into effect in June 2010. This is compared to about 675,000 trial modifications that were canceled prior to June 2010.[55]

## Treasury's Assessments of Servicer Performance

Over the years, some have questioned whether mortgage servicers have been implementing HAMP properly. Concerns have been raised that in some cases servicers have wrongly denied eligible borrowers for modifications, repeatedly lost borrowers' paperwork, or otherwise did not evaluate borrowers for HAMP according to program requirements.[56]

Since April 2011, Treasury has released results of examinations of the performance of the largest servicers participating in HAMP on a quarterly basis. As a result of the first servicer examination,

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[53] U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, "Obama Administration Kicks Off Mortgage Modification Conversion Drive," press release, November 30, 2009, available at http://treas.gov/press/releases/tg421.htm.

[54] See Treasury's Supplemental Directive 10-01, "Home Affordable Modification Program – Program Update and Resolution of Active Trial Modifications," January 28, 2010, https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1001.pdf.

[55] U.S. Department of the Treasury, *Making Home Affordable Program Performance Report Through the Fourth Quarter of 2016*, p. 7.

[56] For example, see SIGTARP, *Mortgage Servicers Have Denied Four Million Homeowner Applications for HAMP Assistance*, July 29, 2015, https://www.sigtarp.gov/repository/SIGTARP_HAMP_Denials_Report_rAwa2uwr.pdf.

Treasury announced that it would be withholding incentive payments to three of the largest participating servicers due to findings that the servicers' performance under the program was not meeting Treasury's standards. The servicers, Bank of America, JP Morgan Chase, and Wells Fargo, were all found to need "substantial" improvement in several areas.[57] Treasury said that it would reinstate the incentive payments when the servicers' performance improved and was no longer found to need substantial improvement. The remaining 6 of the 10 largest servicers were found to need moderate improvement, but Treasury did not withhold incentive payments from those servicers.[58]

Treasury's subsequent assessments of servicer performance generally showed improvement. As of the fourth quarter of 2016, seven servicers were included in the assessment. In that quarter, one servicer was found to need substantial improvement, one was found to need moderate improvement, and five were found to need minor improvement.[59] Although Treasury's assessments have shown improvements in servicer performance, many have continued to raise concerns about servicers' implementation of HAMP and the extent to which some eligible borrowers may have been wrongly denied modifications or may have their modifications terminated without good cause.[60]

# Home Affordable Refinance Program (HARP)

HARP is the refinancing component of the Making Home Affordable initiative. It applies to mortgages backed by Fannie Mae and Freddie Mac, and the program requirements are set by those entities and their regulator, the Federal Housing Finance Agency (FHFA).

HARP was originally scheduled to end on June 10, 2010, but has been extended multiple times.[61] HARP is currently scheduled to be available until September 30, 2017. FHFA has announced that

[57] A fourth servicer, Ocwen, was found to need substantial improvement as well, but Treasury did not withhold incentive payments from Ocwen at that time due to a finding that its performance was partially due to a loan portfolio that it had bought from another company.

[58] U.S. Department of the Treasury, *Making Home Affordable Program Performance Report through April 2011*, June 9, 2011. Servicer assessment results begin on p. 14. All Making Home Affordable performance reports can be found at https://www.treasury.gov/initiatives/financial-stability/reports/Pages/Making-Home-Affordable-Program-Performance-Report.aspx.

[59] U.S. Department of the Treasury, *Making Home Affordable Program Performance Report through the Fourth Quarter of 2016*, p. 20.

[60] For example, see SIGTARP, *Mortgage Servicers Have Wrongfully Terminated Homeowners Out of the HAMP Program*, January 27, 2016, https://www.sigtarp.gov/Audit%20Reports/Homeowners_Wrongfully_Terminated_Out_of_HAMP.pdf.

[61] HARP was originally scheduled to expire on June 10, 2010. The Federal Housing Finance Agency extended the program five times prior to the most recent extension. In March 2010, FHFA announced that it was extending the program until June 30, 2011. In March 2011, FHFA announced that it was extending the program until June 30, 2012. In October 2011, FHFA announced that it would extend the program until December 31, 2013. In April 2013, it announced that it would extend the program until December 31, 2015, and in May 2015, it announced that it would extend the program until December 31, 2016. See the following Federal Housing Finance Agency press releases: "FHFA Extends Refinance Program by One Year," March 1, 2010, http://fhfa.gov/webfiles/15466/HARPEXTENDED3110%5b1%5d.pdf; "FHFA Extends Refinance Program by One Year," March 11, 2011, http://fhfa.gov/webfiles/20399/HarpExtended0311R.pdf; "FHFA, Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers," October 24, 2011, http://fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf, "FHFA Extends HARP to 2015," April 11, 2013, http://www.fhfa.gov/webfiles/25112/HARPextensionPRFINAL41113.pdf, and "Prepared Remarks of Melvin L. Watt Director FHFA at Greenlining Institute 22nd Annual Economic Summit," May 8, 2015, http://www.fhfa.gov/Media/PublicAffairs/Pages/Prepared-Remarks-FHFA-Director-at-Greenlining-Institute-22nd-Annual-Economic-Summit.aspx.

it will be implementing a new refinancing option for Fannie Mae- and Freddie Mac-backed loans with high loan-to-value ratios in October 2017. HARP was most recently extended so that it will remain available until the new program is in place.[62]

## Program Description

HARP allows certain homeowners with mortgages owned or guaranteed by Fannie Mae or Freddie Mac[63] to refinance their mortgages in order to benefit from lower interest rates, even if the amount owed on the mortgage exceeds 80% of the value of the home. Generally, borrowers who owe more than 80% of the value of their homes have difficulty refinancing their mortgages, and therefore benefitting from lower interest rates, because they do not have enough equity in their homes. By allowing borrowers who owe more than 80% of the value of their homes to refinance their mortgages, HARP is meant to help qualified borrowers lower their monthly mortgage payments to a level that is more affordable. Rather than targeting homeowners who are behind on their mortgage payments, HARP targets homeowners who have kept up with their payments but have lost equity in their homes due to falling home prices.

Originally, qualified borrowers were eligible to refinance through HARP if they owed up to 105% of the value of their homes (that is, if the loan-to-value ratio, or LTV, was at or below 105%). In July 2009, the program was expanded to include borrowers who owe up to 125% of the value of their homes. In October 2011, as part of a broader package of changes to HARP, the cap on the loan-to-value ratio was removed entirely.

The broader package of changes to HARP that was announced in October 2011 was intended to allow more people to qualify for the program and is commonly referred to as "HARP 2.0."[64] In addition to removing the LTV cap, other changes included eliminating or reducing certain fees paid by borrowers who refinance through HARP, waiving certain representations and warranties made by lenders on the original loans (intended to make lenders more likely to participate in HARP by releasing them from some responsibility for any defects in the original loan), and encouraging greater use of automated valuation models instead of property appraisals in order to streamline the refinancing process.[65]

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[62] Federal Housing Finance Agency, "FHFA Announces New Streamlined Refinance Offering for High LTV Borrowers: HARP Extended through September 2017," press release, August 25, 2016, http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-New-Streamlined-Refinance-Offering-for-High-LTV-Borrowers-HARP-Extended-through-September-2017.aspx.

[63] Borrowers can look up whether their loan is backed by Fannie Mae or Freddie Mac at http://makinghomeaffordable.gov/loan_lookup.html. Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that were chartered by Congress to provide liquidity to the mortgage market. Rather than make loans directly, the GSEs buy loans made in the private market and either hold them in their own portfolios or securitize and sell them to investors. The GSEs were placed in voluntary conservatorship by their regulator, the Federal Housing Finance Agency, on September 7, 2008. For more information on the GSEs, see CRS Report R44525, *Fannie Mae and Freddie Mac in Conservatorship: Frequently Asked Questions*, by N. Eric Weiss.

[64] Federal Housing Finance Agency, "FHFA, Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers," press release, October 24, 2011, http://fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf. Many of these changes became effective in December 2011 or January 2012; however, specific changes went into effect on different dates.

[65] Fannie Mae and Freddie Mac each released their own guidance governing how the HARP changes were implemented for loans that they own or guarantee. Fannie Mae's detailed guidance on the program changes is at https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2011/sel1112.pdf, while Freddie Mac's is at http://www.freddiemac.com/sell/guide/bulletins/pdf/bll1122.pdf.

## Basic Eligibility Criteria

Mortgages must meet a variety of requirements in order to be eligible for HARP.[66] Some of the key eligibility criteria include the following:

- the original mortgage must be owned or guaranteed by Fannie Mae or Freddie Mac (limiting the program to mortgages that are already backed by Fannie Mae or Freddie Mac ensures that these entities do not take on any new risk by backing the refinanced mortgages),
- the mortgage must be for a single-family home,
- the original mortgage must have closed on or before May 31, 2009,[67] and
- the borrower must be current on the mortgage payments.

HARP is voluntary, and lenders are not required to refinance mortgages through the program even if the mortgages meet all of the eligibility criteria. Because HARP is a refinancing program, which involves taking out a new mortgage, borrowers can shop around to different lenders to refinance through HARP.

## HARP Results to Date

The Administration originally estimated that HARP could help up to between 4 million and 5 million homeowners. According to the Federal Housing Finance Agency, about 3.4 million loans with loan-to-value ratios above 80% had refinanced through HARP as of December 2016.[68] The majority of these mortgages (2.4 million) had loan-to-value ratios between 80% and 105%, while about 590,000 mortgages had loan-to-value ratios above 105% up to 125% and about 433,000 mortgages had loan-to-value ratios above 125%. **Table 2** shows the number of HARP refinances completed by Fannie Mae and Freddie Mac since the program began.

**Table 2. Number of HARP Refinances**
As of December 2016

| | Fannie Mae | Freddie Mac | Total |
|---|---|---|---|
| LTV over 80% up to 105% | 1,454,154 | 970,343 | **2,424,497** |
| LTV over 105% up to 125% | 329,181 | 261,149 | **590,330** |

[66] Fannie Mae and Freddie Mac each administer their own HARP programs. More information on the detailed requirements to qualify for HARP is available on each of their websites. See Fannie Mae's website at "Home Affordable Refinance," https://www.fanniemae.com/singlefamily/making-home-affordable?taskId=task-57. See Freddie Mac's website at "Relief Refinance Mortgages – Same Servicer," http://www.freddiemac.com/singlefamily/factsheets/sell/relief_refi_same_servicer.html and "Relief Refinance Mortgages – Open Access," http://www.freddiemac.com/singlefamily/factsheets/sell/relief_refi_open_access.html.

[67] Originally, the original mortgage must have been delivered to Fannie Mae and Freddie Mac on or prior to May 31, 2009. Because there is often a lag between when a mortgage closes and when it is sold and delivered to Fannie Mae or Freddie Mac, this meant that some mortgages that had closed on or prior to May 31, 2009, may not have been eligible if they had not also been delivered to Fannie or Freddie prior to that date. In October 2013, Fannie Mae and Freddie Mac each announced that HARP would now be open to mortgages that closed on or prior to May 31, 2009, regardless of the date that the mortgage was delivered. See Fannie Mae Selling Guide Announcement SEL-2013-08, dated October 22, 2013, at https://www.fanniemae.com/content/announcement/sel1308.pdf; and Freddie Mac, "Revised Eligibility Date for Relief Refinance Mortgages," October 22, 2013, at http://www.freddiemac.com/singlefamily/news/2013/1022_revised_eligibility_date.html.

[68] Federal Housing Finance Agency, *Refinance Report December 2016*, p. 3, https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Refi_4Q2016.pdf.

| | Fannie Mae | Freddie Mac | Total |
|---|---|---|---|
| LTV over 125% | 257,273 | 175,571 | **432,844** |
| **Total** | **2,040,608** | **1,407,063** | **3,447,671** |

**Source:** Federal Housing Finance Agency, *Refinance Report, Fourth Quarter 2016*, https://www.fhfa.gov/AboutUs/Reports/Pages/Refinance-Report-Fourth-Quarter-2016.aspx.

# Hardest Hit Fund

Another temporary program created by Treasury is the Hardest Hit Fund (HHF). The HHF provides funds to selected states to use to create foreclosure prevention programs that fit local conditions. Ultimately, 18 states plus the District of Columbia were selected to receive funds through the HHF through several rounds of funding. The funding comes from the TARP funds that Treasury initially set aside for HAMP. Therefore, all Hardest Hit Fund funding must be used in ways that comply with the law that authorized TARP, the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), and state HHF programs must be approved by Treasury.

States originally had until December 31, 2017, to use their funds. In 2016, Treasury extended the deadline to December 31, 2020.[69]

## HHF Funding: Rounds One through Four

Initially, there were four rounds of funding through the Hardest Hit Fund. Each round of funding made funds available to certain state housing finance agencies (HFAs) based on certain state characteristics. The Administration set maximum allocations for each state based on a formula, and the HFAs of those states were required to submit their plans for the funds to Treasury for approval in order to receive funds through the program.

The first four rounds of funding were as follows:

- **First Round:** On February 19, 2010, the Obama Administration announced that it would make up to a total of $1.5 billion available to the HFAs of five states that had experienced the greatest declines in home prices.[70] The five states are California, Arizona, Florida, Nevada, and Michigan. The participating states can use the funding for a variety of programs that address foreclosures and are tailored to specific areas, including programs to help unemployed homeowners, programs to help homeowners who owe more than their homes are worth, or programs to address the challenges that second liens pose to mortgage modifications.
- **Second Round:** On March 29, 2010, a second round of funding made up to a total of $600 million available to five states that had large proportions of their populations living in areas of economic distress, defined as counties with unemployment rates above 12% in 2009 (the five states that received funding in

[69] U.S. Department of the Treasury, *Hardest Hit Fund First Quarter 2016 Performance Summary*, p. 2, https://www.treasury.gov/initiatives/financial-stability/reports/Documents/Hardest%20Hit%20Fund%20Program%20Performance%20Summary%20Q1%202016.pdf

[70] U.S. Department of the Treasury, "Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets ("HFA Hardest-Hit Fund"): Guidelines for HFA Proposal Submission," https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Documents/HFA%20Proposal%20Guidelines%20-%201st%20Rd.pdf.

the first round were not eligible). The five states that received funding through this second round are North Carolina, Ohio, Oregon, Rhode Island, and South Carolina. These states can use the funds to support the same types of programs eligible under the first round of funding, and are subject to the same requirements.[71]

- **Third Round:** On August 11, 2010, a third round of funding made a total of up to $2 billion available to 18 states and the District of Columbia, all of which had unemployment rates higher than the national average over the previous year.[72] Nine of the states that received funds through the third round of funding also received funding in one of the previous two rounds of Hardest Hit Fund funding.[73] The states that received funding in the third round but not in either of the previous two rounds are Alabama, Georgia, Illinois, Indiana, Kentucky, Mississippi, New Jersey, Tennessee, and the District of Columbia. Like the first two rounds of funding, states had to submit plans for the funds for Treasury's approval. Unlike the first two rounds of funding, states have to use funds from the third round specifically for foreclosure prevention programs that target the unemployed.
- **Fourth Round:** In September 2010, Treasury announced an additional $3.5 billion of funding to be distributed to the 18 states (and the District of Columbia) that were receiving funding through earlier rounds, bringing the total amount of funding allocated to the HHF to $7.6 billion.

## HHF Funding: Round Five

Treasury's authority to make additional commitments of TARP funds expired on October 3, 2010, meaning that Treasury could no longer allocate additional TARP funds to the HHF after that time. However, in December 2015 the Consolidated Appropriations Act, 2016 (P.L. 114-113) authorized Treasury to make up to an additional $2 billion in unused TARP funds available to the HHF. In February 2016, Treasury announced that it was allocating an additional $2 billion to the states participating in the HHF.

The $2 billion was allocated in two phases.[74] First, $1 billion was allocated to participating states based on population and utilization of previous HHF funds. States must have used at least 50% of their previous HHF funds to be eligible for this funding.[75] Each participating state except for Alabama received additional HHF funding in this first phase of Round Five. Second, an

[71] U.S. Department of the Treasury, "Second Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets ("HFA Hardest-Hit Fund"): Guidelines for HFA Proposal Submission," https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Documents/HFA%20Proposal%20Guidelines%202%200%20—%20041110%20FINAL.pdf.

[72] U.S. Department of the Treasury, "Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets ("HHF"): Guidelines for HFA Proposal Submission for Unemployment Programs," https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Documents/HFA%20Proposal%20Guidelines%20Third%20Funding%20FINAL.pdf.

[73] Except for Arizona, every state that received funding in one of the first two rounds of the Hardest Hit Fund also received funding in the third round.

[74] Department of the Treasury, "Treasury Announces Additional Investment in Hardest Hit Fund," press release, February 19, 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl0358.aspx.

[75] Based on this threshold, one participating HHF state, Alabama, was not eligible to receive additional funding in this phase.

additional $1 billion was allocated competitively among participating states. All but six participating states received additional HHF funding in this second phase of Round Five. Five states did not apply for funding in Phase Two (Alabama, Arizona, Florida, Nevada, and South Carolina), and one state applied but was not awarded funding (Georgia).[76]

The additional funding brings the total amount committed to the HHF to $9.6 billion.

## State Funding Allocations

**Table 3** shows the total funding that each participating state has received through the Hardest Hit Fund. In addition to the total, it shows the aggregate amount that each state received in Rounds 1 through 4, and the amount received through each of the phases of Round 5.

**Table 3. Hardest Hit Fund Allocations to States**

dollars in millions

| | Total Funding Allocated, All Rounds | *Funds Allocated in Rounds 1-4* | *Funds Allocated in Round 5, Phase 1* | *Funds Allocated in Round 5, Phase 2* |
|---|---|---|---|---|
| Alabama | **$162.5** | *$162.5* | *N/A* | *N/A* |
| Arizona | **$296.0** | *$267.8* | *$28.3* | *N/A* |
| California | **$2,358.6** | *$1,975.3* | *$213.5* | *$169.8* |
| Florida | **$1,135.7** | *$1,057.8* | *$77.9* | *N/A* |
| Georgia | **$370.1** | *$339.3* | *$30.9* | *N/A* |
| Illinois | **$715.1** | *$445.6* | *$118.2* | *$151.3* |
| Indiana | **$283.7** | *$221.7* | *$28.6* | *$33.5* |
| Kentucky | **$207.0** | *$148.9* | *$30.1* | *$28.0* |
| Michigan | **$761.2** | *$498.6* | *$74.5* | *$188.1* |
| Mississippi | **$144.3** | *$101.9* | *$19.3* | *$23.1* |
| Nevada | **$202.9** | *$194.0* | *$8.9* | *N/A* |
| New Jersey | **$415.1** | *$300.5* | *$69.2* | *$45.4* |
| North Carolina | **$706.5** | *$482.8* | *$78.0* | *$145.7* |
| Ohio | **$762.3** | *$570.4* | *$97.6* | *$94.3* |
| Oregon | **$314.6** | *$220.0* | *$36.4* | *$58.1* |
| Rhode Island | **$116.0** | *$79.4* | *$9.7* | *$26.9* |
| South Carolina | **$317.5** | *$295.4* | *$22.0* | *N/A* |
| Tennessee | **$302.1** | *$217.3* | *$51.9* | *$32.8* |
| Washington, DC | **$28.7** | *$20.7* | *$4.9* | *$3.1* |
| **Total** | **$9,600.0** | ***$7,600.0*** | ***$1,000.0*** | ***$1,000.0*** |

**Source:** Treasury's Hardest Hit Fund website at https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx and Department of the Treasury, "Treasury Announces Allocation of Final $1 Billion Among Hardest Hit Fund States," press release, April 20, 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl0434.aspx.

[76] Department of the Treasury, "Treasury Announces Allocation of Final $1 Billion among Hardest Hit Fund States," press release, April 20, 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl0434.aspx.

As of the end of December 2016, over $7 billion, or more than 70%, of HHF funds had been drawn down by states. (Funds that have been drawn down by states may or may not have actually been spent by the states to date.[77] In order to draw down additional amounts from Treasury, a state may not have more than 5% of its total allocation on hand.) The percentages of their allocations that individual states have drawn from Treasury range from a low of 35% (Alabama) to a high of 89% (Oregon), with most states falling somewhere in between.[78] These percentages take into account all HHF funds, including those allocated through Round Five.

## State Hardest Hit Fund Programs

As described, states had flexibility to design different types of programs using their Hardest Hit Fund allocations, as long as their programs met the purposes of the Emergency Economic Stabilization Act and were approved by Treasury. State HFAs may operate one or more programs with their HHF funds. (States that received funding in the third round are required to use those funds to assist unemployed homeowners.) In general, the types of programs that states have implemented fall under a few broad categories: standard mortgage modification programs, principal reduction programs, mortgage reinstatement programs (to help borrowers pay arrearages and late fees to bring a mortgage current again), programs to help unemployed homeowners with mortgage payments, programs to address second liens, programs to facilitate short sales or deeds-in-lieu of foreclosure, and, more recently, blight elimination programs (programs for demolishing vacant or abandoned homes that are contributing to blight) and down payment assistance programs (intended to help prevent foreclosures by encouraging home buying activity).[79] Some states have also used HHF funds for other types of programs to help prevent foreclosures, such as assisting homeowners with reverse mortgages or helping to pay tax liens on properties.

According to Treasury, as of the fourth quarter of 2016 there were more than 80 Hardest Hit Fund programs operating in the 18 states (plus DC) that received Hardest Hit Fund allocations, and these programs had assisted over 290,000 borrowers.[80] States have continued to add or make changes to their Hardest Hit Fund programs.[81]

[77] For information on the amount of HHF funding that each state has actually disbursed, rather than the amount it has drawn from Treasury, see Treasury's quarterly Hardest Hit Fund performance summaries at http://www.treasury.gov/initiatives/financial-stability/reports/Pages/HHF.aspx.

[78] U.S. Department of the Treasury, *Monthly Report to Congress on the Troubled Asset Relief Program, December 2016*, January 10, 2017, p. 4, https://www.treasury.gov/initiatives/financial-stability/reports/Documents/2016.12%20December%20Monthly%20Report%20to%20Congress.pdf.

[79] Brief descriptions of each participating state's HHF programs are included in Treasury's quarterly *Hardest Hit Fund Performance Summaries*, available at http://www.treasury.gov/initiatives/financial-stability/reports/Pages/HHF.aspx. More detailed information on state programs is included in each state HFA's Hardest Hit Fund agreement with Treasury and related amendments, available at http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx.

[80] U.S. Department of the Treasury, *Hardest Hit Fund Fourth Quarter 2016 Performance Summary*, p. 4. Quarterly performance summaries for the Hardest Hit Fund are available on Treasury's website at http://www.treasury.gov/initiatives/financial-stability/reports/Pages/HHF.aspx.

[81] Treasury's quarterly performance summaries on the Hardest Hit Fund and Treasury's monthly reports to Congress on the Troubled Asset Relief Program generally include information on changes that states have made to their HHF programs. The monthly reports to Congress on the Troubled Asset Relief Program are available on Treasury's website at http://www.treasury.gov/initiatives/financial-stability/reports/Pages/Monthly-Report-to-Congress.aspx.

# FHA Short Refinance Program

On March 26, 2010, the Administration announced a new Federal Housing Administration (FHA) Short Refinance Program for homeowners who owed more on their mortgages than their homes were worth. Detailed program guidance was released on August 6, 2010.[82] The FHA Short Refinance Program began on September 7, 2010, and ended on December 31, 2016.[83]

Under the FHA Short Refinance Program, certain homeowners who owed more than their homes were worth were eligible to refinance into new, FHA-insured mortgages for an amount lower than the home's current value. Specifically, the new mortgage could not have a loan-to-value ratio of more than 97.75%. The original lender would accept the proceeds of the new loan as payment in full on the original mortgage; the new lender would have FHA insurance on the new loan; and the homeowner would have a first mortgage balance that was below the current value of the home, thereby giving him or her some equity in the home. Homeowners had to be current on their mortgages to qualify for this program. Further, the balance on the first mortgage loan had to be reduced by at least 10%. This program was voluntary for lenders and borrowers, and borrowers with mortgages already insured by FHA were not eligible.

The FHA Short Refinance Program was similar in structure to the Hope for Homeowners program (described in the **Appendix**), which was still active at the time that the FHA Short Refinance Program began but ended in 2011. However, there were some key differences between the two programs. First, Hope for Homeowners required that any second liens on the property be extinguished. Under the FHA Short Refinance Program, second liens were specifically allowed to remain in place. Incentives were offered for the second lien-holder to reduce the balance of the second lien, and the homeowner's combined debt on both the first and the second lien was not allowed to exceed 115% of the value of the home after the refinance. Second, under Hope for Homeowners, borrowers could be either current or delinquent on their mortgages and qualify for the program. Under the FHA Short Refinance Program, borrowers had to be current on their mortgages. Finally, under Hope for Homeowners, borrowers had to agree to share some of their initial equity in the home with the government when the house was eventually sold. The FHA Short Refinance Program did not appear to require any equity or appreciation sharing.

As of the end of December 2016, FHA reported insuring about 7,200 refinanced loans through the program.[84] While the program expired on December 31, 2016, it is possible that FHA could insure some additional mortgages where the applications were received prior to the deadline. Treasury originally planned to use up to $8 billion of the TARP funds originally set aside for HAMP to pay for the cost of this program, but given the low volume of participation and the associated lower number of defaults expected under the program, it has since reduced the total

[82] FHA Mortgagee Letter 2010-23, "FHA Refinance of Borrowers in Negative Equity Positions," August 6, 2010, available at https://portal.hud.gov/hudportal/documents/huddoc?id=10-23ml.pdf.

[83] The program was extended to December 31, 2016, by FHA Mortgagee Letter 2014-23, "FHA Refinance of Borrowers in Negative Equity Positions: Program Extension," https://portal.hud.gov/hudportal/documents/huddoc?id=14-23ml.pdf. During the 112th Congress, the House of Representatives passed a bill (H.R. 830) which, if enacted, would have terminated the FHA Short Refinance Program and rescinded unexpended funds. Borrowers whose loans had already been refinanced through the program would not have been affected if this bill became law. CBO estimated that enacting H.R. 830 would have decreased the federal deficit by $175 million (see Congressional Budget Office, H.R. 830 *FHA Refinance Program Termination Act of 2011*, cost estimate, March 7, 2011, http://cbo.gov/ftpdocs/120xx/doc12089/hr830.pdf). The Senate did not consider the bill.

[84] Data obtained from CRS communications with HUD.

maximum amount that it will spend on the program to just over $100 million.[85] Any additional program costs would be borne by FHA.

# Foreclosure Counseling Funding for NeighborWorks America

Another federal effort to slow the rising number of foreclosures has been to provide additional funding for housing counseling.[86] In particular, Congress has provided funding specifically for foreclosure mitigation counseling to be administered by the Neighborhood Reinvestment Corporation, commonly known as NeighborWorks America.[87] NeighborWorks America is a nonprofit organization created by Congress in 1978 that has a national network of community partners. It traditionally engages in a variety of housing and community reinvestment activities, including housing counseling, and also provides training for other nonprofit housing counseling organizations.

The Consolidated Appropriations Act, 2008 (P.L. 110-161) provided $180 million to NeighborWorks to use for housing counseling for borrowers in danger of foreclosure, which it did by setting up the National Foreclosure Mitigation Counseling Program (NFMCP).[88] NeighborWorks competitively awards the funding to qualified housing counseling organizations.[89] Congress directed NeighborWorks to award the funding with a focus on areas with high default and foreclosure rates on subprime mortgages. The Housing and Economic Recovery Act of 2008 (HERA, P.L. 110-289) provided an additional $180 million for NeighborWorks to distribute through the NFMCP, $30 million of which was to be distributed to counseling organizations to provide legal help to homeowners facing delinquency or foreclosure.

Since HERA, Congress continued to provide funding for the NFMCP through annual appropriations acts, in amounts ranging from $40 million to $80 million per year. Funding provided for the NFMCP is shown in **Table 4**. In FY2016, Congress provided $40 million for the NFMCP.[90]

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[85] See U.S. Department of the Treasury, *Troubled Asset Relief Program (TARP) Monthly Report to Congress – April 2013*, pp. 3-4, http://www.treasury.gov/initiatives/financial-stability/reports/Documents/April%202013%20Monthly%20Report%20to%20Congress.pdf and *Troubled Asset Relief Program (TARP) Monthly Report to Congress – March 2015*, p. 5, http://www.treasury.gov/initiatives/financial-stability/reports/Documents/Monthy_Report_Congress_March2015.pdf.

[86] For more information on housing counseling, see archived CRS Report R41351, *Housing Counseling: Background and Federal Role*, by Katie Jones.

[87] Each year, Congress appropriates funding to HUD to distribute to certified housing counseling organizations to undertake various types of housing counseling, including prepurchase counseling and post-purchase counseling. Congress also appropriates funding to NeighborWorks each year for neighborhood reinvestment activities, including housing counseling. The recent funding provided to NeighborWorks specifically for foreclosure mitigation counseling is separate from both of these other usual appropriations.

[88] For more information on the National Foreclosure Mitigation Counseling Program, see the NeighborWorks website at http://www.nw.org/network/nfmcp/default.asp#info.

[89] HUD-approved housing counseling intermediaries, state housing finance agencies, and NeighborWorks organizations are eligible to receive funds through the NFMCP.

[90] The NFMCP was intended to provide temporary funding for foreclosure mitigation counseling. The President's budget did not request funding for the NFMCP in FY2017, and neither the House committee-passed nor the Senate-passed versions of the FY2017 HUD appropriations bill would have provided funding for the NFMCP. As of the date of this report, the government was operating under a continuing resolution, and a final FY2017 appropriations law had not been enacted.

**Table 4. Funding for the National Foreclosure Mitigation Counseling Program**

Dollars in millions

| Law | Date Enacted | Amount |
|---|---|---|
| Consolidated Appropriations Act, 2008 (P.L. 110-161) | December 26, 2007 | $180 |
| Housing and Economic Recovery Act of 2008 (P.L. 110-289) | July 30, 2008 | $180 |
| Omnibus Appropriations Act, 2009 (P.L. 111-8) | March 11, 2009 | $50 |
| Consolidated Appropriations Act, 2010 (P.L. 111-117) | December 16, 2009 | $65 |
| Department of Defense and Full-Year Continuing Appropriations Act, 2011 (P.L. 112-10) | April 15, 2011 | $65 |
| Consolidated and Continuing Appropriations Act, 2012 (P.L. 112-55) | November 18, 2011 | $80 |
| Consolidated and Further Continuing Appropriations Act, 2013 (P.L. 113-6) | March 26, 2013 | $76 |
| Consolidated Appropriations Act, 2014 (P.L. 113-76) | January 17, 2014 | $67.5 |
| Consolidated and Further Continuing Appropriations Act, 2015 (P.L. 113-235) | December 16, 2014 | $50 |
| Consolidated Appropriations Act, 2016 (P.L. 114-113) | December 18, 2015 | $40 |

**Source:** Annual appropriations acts and the NeighborWorks FY2013 Operating Plan, available at http://www.nw.org/network/aboutUs/policy/documents/FY2013OperatingPlan.pdf.

**Notes:** The funds provided in P.L. 110-289 included funding for legal assistance for homeowners facing foreclosure. Funding for FY2013 takes into account reductions due to sequestration and a 0.2% across-the-board rescission.

NeighborWorks reports that, as of April 30, 2016, over 2 million borrowers received foreclosure prevention counseling through the NFMCP. Evaluations of the program have found that borrowers who received counseling through the NFMCP were more likely to receive loan modifications, and more likely to remain current on their mortgages after receiving a loan modification, than borrowers who did not receive counseling.[91]

# Issues and Challenges Associated with Preventing Foreclosures

There are several challenges associated with designing successful programs to prevent foreclosures. Some of these challenges are practical and concern issues surrounding the implementation of loan modifications. Other challenges are more conceptual, and are related to questions of fairness and precedent.

[91] NeighborWorks America, *National Foreclosure Mitigation Counseling Program, Congressional Update*, September 23, 2016 (data as of April 30, 2016), pp. 6-7. NFMC Congressional Update reports are available at http://www.neighborworks.org/Homes-Finances/Foreclosure/Foreclosure-Counseling-%28NFMC%29/Congressional-Reports.

This section describes some of the most prominent considerations that were involved in developing programs to preserve homeownership in the years following the increase in foreclosure rates that began in 2006, as well as how some of these challenges were addressed in the years following the programs' establishment. Some of these issues evolved over the years as loan modification programs came into wider use. This section also briefly describes debate over the use of principal reduction in mortgage modifications and the extent to which principal reduction was utilized in mortgage modifications as of the end of 2016.

## Who Has the Authority to Modify Mortgages?

Over the past several decades, the practice of lenders packaging mortgages into securities and selling them to investors has become more widespread. This practice is known as securitization, and the securities that include the mortgages are known as mortgage-backed securities (MBS). When mortgages are sold through securitization, several players become involved with any individual mortgage loan, including the lender, the servicer, and the investors who hold shares in the MBS. The servicer is usually the organization that has the most contact with the borrower, including receiving monthly payments and initiating any foreclosure proceedings. However, servicers are usually subject to contracts with investors which limit the activities that the servicer can undertake and require it to safeguard the investors' financial interest.

One question that has faced foreclosure prevention programs, particularly in the early stages of the response to rising foreclosure rates, has been the extent to which servicers have the authority to make certain loan modifications. Contractual obligations may limit the amount of flexibility that servicers have to modify loans in ways that could arguably yield a lower return for investors. In some cases, loan modifications can result in less of a loss for investors than foreclosure; however, servicers may not want to risk having investors challenge their assessment that a modification is more cost-effective than a foreclosure.

One possible way to partially address the question of who can modify mortgages is to provide a safe harbor for servicers. In general, a safe harbor protects servicers who engage in certain mortgage modifications from lawsuits brought by investors. While proponents of a safe harbor believe that a safe harbor is necessary to encourage servicers to modify more mortgages without fear of legal repercussions, opponents argue that a safe harbor infringes on investors' rights and could even encourage servicers to modify mortgages that are not in trouble if it benefits their own self-interest. The Helping Families Save Their Homes Act of 2009 (P.L. 111-22) provided a safe harbor for servicers who modified mortgages prior to December 31, 2012, in a manner consistent with the Making Home Affordable program guidelines or the since-expired Hope for Homeowners program. The legislation specified that the safe harbor does not protect servicers or individuals from liability for any fraud committed in their handling of the mortgage or the mortgage modification.

The existence of HAMP and other foreclosure prevention programs may have also helped to standardize mortgage modifications to some extent, possibly providing a clearer set of guidelines to servicers about what constitutes an appropriate mortgage modification. The net present value test in programs such as HAMP is intended to help ensure that the modifications servicers make are in the best interest of the investors in the mortgage.

## Volume of Delinquencies and Foreclosures

Another issue that has faced loan modification programs is the high volume of delinquencies and foreclosure proceedings that have been underway since 2007. Lenders and servicers have a limited number of employees to reach out to troubled borrowers and find solutions, and this was

particularly true in the early years of the foreclosure response before servicers increased staffing levels to address the volume of delinquent mortgages. Contacting borrowers—some of whom may avoid contact with their servicer out of embarrassment or fear—and working out large numbers of individual loan modifications can overwhelm the capacity of the lenders and servicers. In addition, the complexity of mortgage modification programs and changes in program requirements can stress servicing staff. Streamlined plans that use a formula to modify all loans that meet certain criteria may make it easier for lenders and servicers to help a greater number of borrowers in a shorter amount of time. However, streamlined plans may be more likely to run into the contractual issues between servicers and investors described above.

## Servicer Incentives

Mortgage servicers are the entities that are often primarily responsible for making the decision to modify a mortgage or to begin the foreclosure process. Some observers have raised concerns that mortgage servicers' compensation structures may provide incentives for them to pursue foreclosure rather than modify loans in certain cases, even if a modification would be in the best interest of the investor as well as the borrower.[92]

Servicers' actions are governed by contracts with mortgage holders or investors that generally require servicers to act in the best interests of the entity on whose behalf they service the mortgages, although, as described above, such contracts may in some cases also include restrictions on servicers' abilities to modify loans. In addition to their contractual obligations, servicers have an incentive to service mortgages in the best interest of investors because that is one way that mortgage servicers ensure that they will attract continued business. However, some have suggested that servicers' compensation structures may provide incentives for servicers to pursue foreclosure even when it is not in the best interest of the investor in the mortgage. For example, servicers' compensation structures may not provide an incentive to put in the extra work that is necessary to modify a mortgage, and servicers may be able to charge more in fees or recoup more expenses through a foreclosure than a modification.[93] Programs such as HAMP provide financial payments to servicers to modify mortgages, but some argue that these may not be large enough to align servicers' incentives with those of borrowers and investors. In 2011, the Federal Housing Finance Agency (FHFA) and HUD announced a joint initiative to consider alternative servicer compensation structures.[94]

## Possibility of Redefault

A challenge associated with loan modification programs is the possibility that a homeowner who receives a modification will nevertheless default on the loan again in the future. This possibility might be of particular concern for lenders or investors if the home's value is falling, because in that case delaying an eventual foreclosure reduces the value that the mortgage holder can recoup

[92] For example, see Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, Washington Law Review, Vol. 86, pages 755-840, https://digital.law.washington.edu/dspace-law/bitstream/handle/1773.1/1074/86WLR755.pdf?sequence=1.

[93] For discussions of the economics of mortgage servicing, see Section 3 of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) Quarterly Report to Congress, October 26, 2010, available at http://www.sigtarp.gov/Quarterly%20Reports/October2010_Quarterly_Report_to_Congress.pdf, and Larry Cordell et. al., "The Incentives of Mortgage Servicers: Myths and Realities," Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington, DC, http://www.federalreserve.gov/pubs/feds/2008/200846/200846pap.pdf.

[94] See Federal Housing Finance Agency, "Joint Mortgage Servicing Initiative," http://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Joint-Mortgage-Servicing-Initiative.aspx.

through a foreclosure sale. Furthermore, modified mortgages that default again in the future can potentially harm borrowers. If a borrower defaults again and eventually loses his home to foreclosure, he may have been better off going through foreclosure earlier rather than making modified mortgage payments for a period of time when that money could have been put to another use.

According to data from the Office of the Comptroller of the Currency (OCC), redefault rates for modified mortgages improved dramatically over the years. For loans that were modified in 2008, nearly 45% were at least 60 days delinquent again six months after the modification, and over 60% were at least 60 days delinquent again three years after the modification. In contrast, for loans modified in 2012, about 13% were at least 60 days delinquent six months after the modification and 17% were 60 days delinquent three years after the modification. The six-month redefault rate for mortgages modified in subsequent years remained in a similar range.[95] A number of factors may have contributed to the improvement in redefault rates over the years, including changes in the types of loan modifications being offered, improvements in mortgage servicers' responses to delinquent borrowers, and improving housing market conditions.

The OCC also reports data that show redefault rates according to whether the loan modification increased monthly payments, decreased monthly payments, or left monthly payments unchanged. The reports include such data for loans modified since the beginning of 2008. The report covering the third quarter of 2015 shows that, for loans modified in 2014, about 15% of loan modifications that resulted in monthly payments being reduced by 20% or more were 60 or more days delinquent 12 months after modification. This compares to a redefault rate of 22% for loans where monthly payments were reduced by between 10% and 20%; 28% for loans where payments were reduced by less than 10%; 31% for loans where payments remained unchanged; and 33% for loans where monthly payments increased. While loan modifications that lower monthly payments do appear to perform better than modifications that increase monthly payments, a significant number of modified loans with lower monthly payments still become delinquent again after the loan modification.[96]

## Possibility of Distorting Borrower Incentives

Another challenge is that loan modification programs may provide an incentive for borrowers to intentionally miss payments or default on their mortgages in order to qualify for a loan modification that provides more favorable mortgage terms. While many of the programs described above specifically require that a borrower must not have intentionally missed payments on his or her mortgage in order to qualify for the program, it can be difficult to prove a person's intention. Programs that are designed to reach out to distressed borrowers before they miss any payments, as well as those who are already delinquent, may minimize the incentive for homeowners to intentionally fall behind on their mortgages in order to receive help.

## Fairness Issues

Opponents of some foreclosure prevention plans argue that it is not fair to help homeowners who have fallen behind on their mortgages while homeowners who may be struggling to stay current receive no help. Others argue that borrowers who took out mortgages that they knew they could

[95] Office of the Comptroller of the Currency, *OCC Mortgage Metrics Report, Third Quarter 2015*, pp. 33-35, http://occ.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics/mortgage-metrics-q3-2015.pdf.

[96] *OCC Mortgage Metrics Report*, p. 36-38.

not afford should not receive federal government assistance. Supporters of loan modification plans point out that many borrowers go into foreclosure for reasons outside of their control, and that some troubled borrowers may have been victims of deceptive, unfair, or fraudulent lending practices. Furthermore, some argue for foreclosure prevention programs because foreclosures can create problems for other homeowners in the neighborhood by depressing property values or putting a strain on local governments.

To address these concerns about fairness, some loan modification programs reach out to borrowers who are struggling to make payments but are not yet delinquent on their mortgages. Most programs also specifically exclude individuals who provided false information in order to obtain a mortgage.

## Precedent

Some opponents of government efforts to provide or encourage loan modifications argue that changing the terms of a contract retroactively sets a troubling precedent for future mortgage lending. These opponents argue that if lenders or investors believe that they could be required or encouraged to change the terms of a mortgage in the future, they will be less likely to provide mortgage loans in the first place or will only do so at higher interest rates to counter the perceived increase in the risk of not being repaid in full. Most existing programs attempt to address this concern by limiting the program's scope. Often, these programs apply only to mortgages that were originated during a certain time frame, and end at a predetermined date, although the end dates for several programs have been extended multiple times.

## Debate Over the Use of Principal Reduction in Mortgage Modifications

While the federal government has undertaken several types of initiatives to help prevent foreclosures—including encouraging mortgage modifications, facilitating refinancing for underwater borrowers, and providing funding for counseling—over the years some policymakers and others have argued for additional actions to be taken to assist troubled borrowers. Among other things, some policymakers and advocates have urged wider use of principal reduction, whereby the mortgage holder forgives some of the principal amount that the borrower owes.

Mortgages that are not backed by Fannie Mae or Freddie Mac or government agencies such as the Federal Housing Administration (FHA) are eligible for principal reduction at the discretion of the mortgage holder. According to data from the Office of the Comptroller of the Currency (OCC), for mortgages modified in the third quarter of 2015, about 25% of modifications of mortgages held by private investors and 29% of modifications of mortgages held in bank portfolios included principal reduction. However, only about 8% of the total number of mortgages modified in the third quarter of 2015 included principal reduction.[97]

Given over 3 million homes with mortgages continued to be in negative equity positions as of the fourth quarter of 2016,[98] advocates of principal reduction argue that increasing its use could be an effective tool in preventing foreclosures. Proponents of principal reduction argue that it can provide an advantage over other types of modifications because it better aligns the amount a

[97] Office of the Comptroller of the Currency, *OCC Mortgage Metrics Report Third Quarter 2015*, pp. 21and 24, http://occ.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics/mortgage-metrics-q3-2015.pdf.

[98] CoreLogic, *CoreLogic Equity Report Fourth Quarter 2016*, p. 9, http://www.corelogic.com/research/negative-equity/equity-report-q4-2016-screen-030817.pdf.

borrower owes with the amount that the house is worth, possibly giving borrowers more of an incentive to remain current on the modified mortgage. Advocates also argue that reducing principal can be in the best interest of mortgage holders if the cost of principal reduction is less than the cost of foreclosure.

Those who oppose more widespread use of principal reduction argue that monthly mortgage payments can be reduced without forgiving mortgage principal, that reducing principal for some borrowers is unfair to others who do not benefit from such relief, and that greater use of principal reduction could encourage some people to purposely default on their mortgages to try to qualify for principal reduction.[99]

Programs such as the HAMP Principal Reduction Alternative (PRA), described earlier in this report, provided incentives for reducing mortgage principal for certain borrowers. However, mortgages backed by the Federal Housing Administration (FHA) are not eligible for principal reduction, nor are most mortgages backed by Fannie Mae or Freddie Mac. The Federal Housing Finance Agency (FHFA), the regulator of Fannie Mae and Freddie Mac, has generally not allowed principal reduction on mortgages backed by those entities, either through the PRA or otherwise. However, in April 2016 Fannie Mae and Freddie Mac announced the availability of a principal reduction modification for a limited number of borrowers. Only borrowers with mortgages backed by Fannie Mae or Freddie Mac who met specific criteria were eligible for this principal reduction. Servicers sent solicitation letters to eligible borrowers, and the deadline for servicers to offer eligible borrowers a principal reduction modification was December 31, 2016.[100] FHFA estimated that approximately 33,000 borrowers may be eligible.[101]

[99] For a more detailed discussion of the arguments for and against more widespread use of principal reduction, as well as legislative proposals related to principal reduction from the 112th Congress, see archived CRS Report R42480, *Reduce, Refinance, and Rent? The Economic Incentives, Risks, and Ramifications of Housing Market Policy Options,* by Sean M. Hoskins.

[100] For more information on the FHFA Principal Reduction Modification, see FHFA's website at https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Principal-Reduction-Modification.aspx.

[101] Federal Housing Finance Agency, "Principal Reduction Modification," fact sheet, April 14, 2016, http://www.fhfa.gov/Media/PublicAffairs/Pages/Principal-Reduction-Modification.aspx.

# Appendix. Earlier Foreclosure Prevention Initiatives

In addition to the foreclosure prevention initiatives described earlier in this report, several other foreclosure prevention initiatives were created or announced in response to the housing market turmoil that began around 2007-2008 but ended in earlier years. Some of these programs were precursors to the programs that are described in the body of this report.

This Appendix briefly describes some of these initiatives. The programs discussed in this Appendix include the Emergency Homeowners Loan Program, Hope for Homeowners, *FHASecure,* Fannie Mae's and Freddie Mac's Streamlined Modification Program, and the FDIC's program for modifying loans that had been held by IndyMac Bank. All of these initiatives expired between 2008 and 2011, although some borrowers may have continued to receive assistance through these programs if they began participating in the program prior to the program's end date.

## Emergency Homeowners Loan Program

The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), which was signed into law by President Obama in July 2010, included up to $1 billion for HUD to use to administer a program to provide short-term loans to certain troubled borrowers who had experienced a decrease in income due to unemployment, underemployment, or a medical emergency, in order to help them make their mortgage payments. HUD chose to provide this funding to the 32 states (and Puerto Rico) that did not receive funding through the Administration's Hardest Hit Fund (described in the "Hardest Hit Fund" section of this report).[102] By statute, HUD was not able to enter into new agreements under this program, called the Emergency Homeowners Loan Program (EHLP), after September 30, 2011.[103]

EHLP funds were used to provide five-year, zero-interest, nonrecourse loans secured by junior liens on the property to help pay arrearages on the mortgage and to assist the borrower in making mortgage payments for up to 24 months going forward.[104] An individual borrower was eligible to receive up to a maximum loan of $50,000.

To qualify for the EHLP, borrowers had to meet certain conditions, including the following:

- borrowers must have had a household income of 120% or less of area median income prior to the unemployment, underemployment, or medical event that made the household unable to make its mortgage payments;
- borrowers must have had a current gross income that was at least 15% less than the household's income prior to the unemployment, underemployment, or medical event;
- borrowers must have been at least three months delinquent and have received notification of the lender's intent to foreclose;

[102] U.S. Department of Housing and Urban Development, *Obama Administration Announces $1 Billion in Additional Help for Struggling Homeowners in 32 States and Puerto Rico*, press release, October 5, 2010, available at http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-225.

[103] In the 112th Congress, the House passed H.R. 836, which would have terminated the EHLP and rescinded any unobligated program balances. Any borrowers who had already received loans through the program would not have been affected if the bill had become law. CBO estimated that enacting H.R. 836 would have decreased the federal budget deficit by $840 million. (See Congressional Budget Office, H.R. 836 Emergency Mortgage Relief Program Termination Act of 2011, cost estimate, March 7, 2011, http://cbo.gov/ftpdocs/120xx/doc12090/hr836.pdf.)

[104] Information on program requirements can be found in HUD's "Emergency Homeowner Loan Program – Summary," available at http://www.hud.gov/offices/hsg/sfh/hcc/msgs/EHLP100810.pdf.

- borrowers must have had a reasonable likelihood of being able to resume making full monthly mortgage payments within two years, and had a total debt-to-income ratio of less than 55%; and
- borrowers must have resided in the property as a principal residence, and the property must have been a single-family (one- to four-unit) property.

Borrowers were required to contribute 31% of their monthly gross income at the time of their application (but in no case less than $25) to monthly payments on the first mortgage, and were required to report any changes in income or employment status while they were receiving assistance. The assistance ends when one of the following events occurs: (1) the maximum assistance amount has been reached; (2) the household regains an income level of 85% or more of its income prior to the unemployment or medical event; (3) the homeowner no longer resides in or sells the property or refinances the mortgage; (4) the borrower defaults on his portion of the first mortgage payments; or (5) the borrower fails to report changes in employment status or income.

Borrowers are not required to make payments on the EHLP loans for a five-year period as long as the borrowers remain in the properties as their principal residences and stay current on their first mortgage payments. If these conditions are met, the balance of the EHLP loan declines by 20% annually until the debt is extinguished at the end of five years. However, the borrower will be responsible for repaying the loan to HUD under certain circumstances.[105]

HUD has not released final data on how many borrowers participated in the program. Media reports from the time the program ended suggested that between 10,000 and 15,000 borrowers may have been assisted, with only about half of the funding allocated to the program ultimately being spent.[106] Participation may have been lower than initially anticipated in part because of delays in getting the program started and borrowers having difficulty meeting the eligibility criteria to qualify for assistance.

## Hope for Homeowners

Congress created the Hope for Homeowners (H4H) program in the Housing and Economic Recovery Act of 2008 (P.L. 110-289), which was signed into law by President George W. Bush on July 30, 2008. The program, which was voluntary on the part of both borrowers and lenders, offered certain borrowers the ability to refinance into new mortgages insured by FHA if their lenders agreed to certain conditions. Hope for Homeowners began on October 1, 2008, and ended on September 30, 2011.[107]

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[105] Participating borrowers must repay the EHLP assistance if (1) the borrower retains ownership of the home but no longer resides in it as a principal residence; (2) the borrower defaults on his or her first mortgage payments; or (3) the borrower receives net proceeds from selling the home or refinancing the mortgage. In the third case, if the proceeds of the sale or refinance are not sufficient to repay the entire remaining balance of the loan, the remaining balance will be considered to have been paid in full and the lien on the property will be released.

[106] For example, see Joseph De Avila, "Mortgage Aid Effort Falls Short of Its Goal," *Wall Street Journal*, September 29, 2011, http://online.wsj.com/article/SB10001424052970203405504576599110626013214.html and Cara Buckley, "U.S. Mortgage-Aid Program Is Shutting Down, With Up to $500 Million Unspent," *New York Times*, September 28, 2011, http://www.nytimes.com/2011/09/29/nyregion/emergency-homeowners-aid-ending-with-up-to-500-million-unspent.html.

[107] FHA issued guidance stating that loans had to receive case numbers by July 29, 2011 in order to be eligible for Hope for Homeowners before the program ended. See FHA Mortgagee Letter 11-20, "Termination of the Hope for Homeowners (H4H) Program," June 10, 2011, http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/11-20ml.pdf.

In order to be eligible for the program, borrowers were required to meet the following requirements:

- The borrower must have had a mortgage that was originated on or before January 1, 2008.
- The borrower's mortgage payments must have been more than 31% of gross monthly income.
- The borrower must not have owned another home.
- The borrower must not have intentionally defaulted on his or her mortgage or any other substantial debt within the last five years, and he or she must not have been convicted of fraud during the last 10 years under either federal or state law.
- The borrower must not have provided false information to obtain the original mortgage.

Under Hope for Homeowners, the lender agreed to write the mortgage down to a percentage of the home's currently appraised value, and the borrower received a new loan insured by the FHA. The new mortgage was a 30-year fixed-rate mortgage with no prepayment penalties, and could not exceed $550,440. Homeowners paid upfront and annual mortgage insurance premiums to FHA, and any second lien-holders were required to release their liens. When the homeowner sells or refinances the home, he or she is required to pay an exit premium to HUD. The exit premium is a percentage of the initial equity the borrower had in the home after the H4H refinance; if the borrower sells or refinances the home during the first year after the H4H refinance, the exit premium is 100% of the initial equity. After five years, the exit premium is 50% of the initial equity.[108]

Congress authorized certain changes to the Hope for Homeowners program in the Emergency Economic Stabilization Act of 2008 (P.L. 110-343) and the Helping Families Save Their Homes Act of 2009 (P.L. 111-22). HUD used the authority granted in both of these laws to make changes to H4H from its original form. For example, HUD lowered the mortgage insurance premiums charged to borrowers; made changes to the maximum loan-to-value ratio on the refinanced loan; offered immediate payments to certain second lien-holders to release their liens; eliminated a requirement for a borrower to share any home price appreciation with HUD when the home was sold or refinanced; and replaced a requirement for a borrower to share equity in the home with HUD with the exit premium.[109] Furthermore, eligibility for the program was limited to borrowers with a net worth below a certain threshold.

The Congressional Budget Office originally estimated that up to 400,000 homeowners could be helped to avoid foreclosure over the life of H4H.[110] In total, about 760 borrowers refinanced through the program.[111] Some have suggested that more borrowers and lenders did not use Hope for Homeowners because the program was too complex. The legislative and administrative

[108] See FHA Mortgagee Letter 09-43, available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2009ml.cfm. Initially, borrowers had to share a portion of both their equity and any appreciation in the home's value with HUD when the home was sold or refinanced. P.L. 111-22 provided the authority to change this requirement.

[109] For the most recent comprehensive guidance on Hope for Homeowners, including these changes, see FHA Mortgagee Letter 09-43, available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2009ml.cfm.

[110] Congressional Budget Office, Cost Estimate, *Federal Housing Finance Regulatory Reform Act of 2008*, June 9, 2008, p. 8, http://www.cbo.gov/ftpdocs/93xx/doc9366/Senate_Housing.pdf.

[111] See Federal Housing Administration, *FHA Outlook*, September 2010 and *FHA Outlook*, September 2011, both available at http://www.hud.gov/offices/hsg/rmra/oe/rpts/ooe/olmenu.cfm.

changes described above were intended to address some of the obstacles to participating in the program.

## FHASecure

*FHASecure* was a program announced by the Federal Housing Administration (FHA) on August 31, 2007, to allow delinquent borrowers with non-FHA adjustable-rate mortgages (ARMs) to refinance into FHA-insured fixed-rate mortgages.[112] The new mortgage helped borrowers by offering better loan terms that either reduced a borrower's monthly payments or helped a borrower avoid steep payment increases under his or her old loan. *FHASecure* expired on December 31, 2008.

To qualify for *FHASecure*, borrowers originally had to meet the following eligibility criteria:[113]

- The borrower had a non-FHA ARM that had reset.
- The borrower became delinquent on his or her loan due to the reset, and had sufficient income to make monthly payments on the new FHA-insured loan.
- The borrower was current on his or her mortgage prior to the reset.
- The new loan met standard FHA underwriting criteria and was subject to other standard FHA requirements (including maximum loan-to-value ratios, mortgage limits, and up-front and annual mortgage insurance premiums).

In July 2008, FHA expanded its eligibility criteria for the program, such as allowing borrowers who were delinquent due to circumstances other than the mortgage reset to participate and relaxing the definition of being current on the mortgage.[114]

*FHASecure* expired on December 31, 2008. In the months before its expiration, some housing policy advocates called for the program to be extended; however, HUD officials contended that continuing the program would be prohibitively expensive, possibly endangering FHA's single-family mortgage insurance program. HUD also pointed to the Hope for Homeowners program as filling the role that *FHASecure* did in helping households avoid foreclosure.[115] Supporters of extending *FHASecure* argued that the statutory requirements of Hope for Homeowners may have offered less flexibility in the face of changing circumstances than *FHASecure*, which could have been more easily amended by HUD.

When *FHASecure* expired at the end of 2008, about 4,000 loans had been refinanced through the program.[116] Critics of the program point to the relatively stringent criteria that borrowers had to meet to qualify for the program as a possible reason that more people did not take advantage of it.

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[112] FHA already offered refinancing options for homeowners who were current on their existing fixed- or adjustable-rate mortgages and continued to do so after the adoption of *FHASecure*.

[113] See FHA Mortgagee Letter 2007-11, "The FHASecure Initiative and Guidance on Appraisal Practices in Declining Markets," available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee/2007ml.

[114] For a description of the changes, see FHA Mortgagee Letter 08-13, "Expansion of FHA Secure," available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee/2008ml.

[115] HUD Mortgagee Letter 08-41, "Termination of *FHASecure*," December 19, 2008, available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2008ml.cfm.

[116] Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009 to 2019," January 2009, available at http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf.

## IndyMac Loan Modifications

On July 11, 2008, the Office of Thrift Supervision in the Department of the Treasury closed IndyMac Federal Savings Bank, based in Pasadena, CA, and placed it under the conservatorship of the Federal Deposit Insurance Corporation (FDIC). In August 2008, the FDIC put into place a loan modification program for holders of mortgages either owned or serviced by IndyMac that were seriously delinquent or in danger of default, or on which the borrower was having trouble making payments because of interest rate resets or a change in financial circumstances. Many of the features of the IndyMac loan modification program were later included in HAMP.

In order to be eligible for a loan modification, the mortgage must have been for the borrower's primary residence and the borrower had to provide current income information that documented financial hardship. Furthermore, the FDIC conducted a net present value test to evaluate whether the expected future benefit to the FDIC and the mortgage investors from modifying the loan would be greater than the expected future benefit from foreclosure.

If a borrower met the above conditions, the loan would be modified to achieve a mortgage debt-to-income (DTI) ratio of 38%. The 38% DTI could be achieved by lowering the interest rate, extending the period of the loan, forbearing a portion of the principal, or a combination of the three. The interest rate would be set at the Freddie Mac survey rate for conforming mortgages, but if necessary it could be lowered for a period of up to five years in order to reach the 38% DTI; after the five-year period, the interest rate would rise by no more than 1% each year until it reached the Freddie Mac survey rate.

Then-FDIC Chairman Sheila Bair estimated that about 13,000 loans were modified under this program while IndyMac was under the FDIC's conservatorship.[117] The FDIC completed a sale of IndyMac to OneWest Bank on March 19, 2009. OneWest agreed to continue to operate the loan modification program subject to the terms of a loss-sharing agreement with the FDIC.[118] OneWest became a participating servicer in HAMP, described earlier in this report.

## Fannie Mae and Freddie Mac Streamlined Modification Program

On November 11, 2008, James Lockhart, then the director of the Federal Housing Finance Agency (FHFA), which oversees Fannie Mae and Freddie Mac, announced a new Streamlined Modification Program for Fannie Mae and Freddie Mac and certain private lenders and servicers.[119] Fannie Mae and Freddie Mac had helped troubled borrowers through individualized loan modifications for some time, but the SMP represented an attempt to formalize the process and set an industry standard. The SMP took effect on December 15, 2008, but was soon replaced by HAMP, which was announced in February 2009 and is described in the "Home Affordable Modification Program (HAMP)" section of this report.

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[117] Remarks by FDIC Chairman Sheila Bair to the National Association of Realtors Midyear Legislative Meeting and Trade Expo, Washington, DC, May 12, 2009. A transcript of these remarks is available at http://www.fdic.gov/news/news/speeches/archives/2009/spmay1209.html.

[118] Federal Deposit Insurance Corporation, "FDIC Closes Sale of IndyMac Federal Bank, Pasadena, California," press release, March 19, 2009, http://www.fdic.gov/news/news/press/2009/pr09042.html.

[119] See Federal Housing Finance Agency, "FHFA Announces Implementation Plans for Streamlined Modification Program," press release, December 18, 2008, http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Implementation-Plans-for-Streamlined-Loan-Modification-Program.aspx. The private mortgage lenders and servicers who participated in the Streamlined Modification Program were primarily members of the HOPE NOW Alliance, a voluntary alliance of industry members that formed to help homeowners avoid foreclosure.

In order for borrowers whose mortgages were owned by Fannie Mae or Freddie Mac to be eligible for the SMP, they had to meet the following criteria:[120]

- The mortgage must have been originated on or before January 1, 2008.
- The mortgage must have had a loan-to-value ratio of at least 90%.
- The home must have been a single-family residence occupied by the borrower, and it must have been the borrower's primary residence.
- The borrower must have missed at least three mortgage payments.
- The borrower must not have filed for bankruptcy.

Mortgages insured or guaranteed by the federal government, such as those guaranteed by FHA, the Department of Veterans Affairs, or the Rural Housing Service, were not eligible for the SMP.

The SMP shared many features of the FDIC's plan to modify troubled mortgages held by IndyMac, and many of these features were also later included in HAMP. Qualified borrowers' monthly mortgage payments were lowered so that the household's mortgage debt-to-income ratio (DTI) was 38% (not including second lien payments). After borrowers successfully completed a three-month trial period (by making all of the payments at the proposed modified payment amount), the loan modification automatically took effect.

In order to reach the 38% mortgage debt-to-income ratio, servicers were required to follow a specific formula. First, the servicer capitalized late payments and accrued interest (late fees and penalties were waived). If this resulted in a DTI of 38% or less, the modification was complete. If the DTI was higher than 38%, the servicer could extend the term of the loan to up to 40 years from the effective date of the modification. If the DTI was still above 38%, the interest rate could be adjusted to the current market rate or lower, but to no less than 3%. Finally, if the DTI was still above 38%, servicers could offer principal forbearance. The amount of the principal forbearance would not accrue interest and was non-amortizing, but would result in a balloon payment when the loan was paid off or the home was sold. Principal forgiveness was not allowed under the SMP.

To encourage participation in the SMP, Fannie Mae and Freddie Mac paid servicers $800 for each loan modification completed through the program. If the SMP did not produce an affordable payment for the borrower, servicers were to work with borrowers in a customized fashion to try to modify the loan in a way that the homeowner could afford.

Fannie Mae and Freddie Mac completed over 51,000 loan modifications between January 2009 and April 2009, when Fannie and Freddie stopped using the SMP and began participating in the Making Home Affordable program instead.[121] However, it is unclear how many of these loan modifications were done specifically through the SMP.

[120] For program requirements, see Fannie Mae's December 12, 2008 Announcement 08-33 at https://www.fanniemae.com/content/announcement/0833.pdf and Freddie Mac's December 12, 2008 Bulletin at http://www.freddiemac.com/singlefamily/guide/bulletins/pdf/bll121208.pdf.

[121] Federal Housing Finance Agency, *Foreclosure Prevention Report: April 2009*, July 15, 2009, available at http://www.fhfa.gov/webfiles/14588/April_Foreclosure_Prevention71509F.pdf.

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