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## HOPE for Homeowners: Too Little, Too Late

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# HOPE for Homeowners: Too Little, Too Late

*Carole O. Heyward*

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## I. Introduction

Participants in the subprime residential mortgage market never envisioned widespread default,<sup>1</sup> and lenders and investors in that market did not foresee the risk involved with subprime loans.<sup>2</sup> The subprime market enjoyed significant growth from 2000 to 2006, increasing from 6 percent of all mortgage loan originations to 25 percent in 2006.<sup>3</sup> As the market grew, originators eased underwriting standards, began writing more loans with adjustable rates, accepted lower or no down payments, and stopped requiring documentation of borrower incomes.<sup>4</sup> Originators of subprime mortgages learned that the sale and securitization of those loans resulted in a quick return of capital and permitted them to make more loans while avoiding the consequences of their underwriting practices.<sup>5</sup> Because underwriting standards were loose and home prices were escalating, most subprime borrowers who encountered financial difficulty before 2007 relied upon escalating housing prices and easily available credit to refinance their way out of trouble.<sup>6</sup> Loan originators who pooled and sold their loans to investors had little incentive to ensure that borrowers could actually afford them.<sup>7</sup>

In early 2007, investors and lenders began to see the results of lax underwriting standards when delinquency rates for subprime loans originated in 2006 greatly exceeded the rates for those loans underwritten before 2005.<sup>8</sup> Lenders responded by tightening credit standards.<sup>9</sup> Private mortgage insurers also tightened underwriting standards, making mortgages even harder to get.<sup>10</sup> As underwriting criteria tightened, many subprime borrowers found that they could not refinance their mortgages.<sup>11</sup>

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Lax underwriting, followed by tightened credit standards and declining home values, have contributed to rapidly escalating rates of foreclosure. The number of foreclosure filings skyrocketed in the first quarter of 2008, when approximately 550,000 homes began the foreclosure process—more than double the average quarterly rate in earlier years.<sup>12</sup> In 2008, an estimated three million loans are predicted to default. This is a sharp increase from 2007 and 2006 when one and a half million and one million loans were in default, respectively.<sup>13</sup>

Nationally, housing prices have declined 16 percent from their high in the spring of 2006.<sup>14</sup> Even greater drops in value have been seen in some areas, such as Sacramento, California, where median home prices have reportedly fallen 34 percent in the last year.<sup>15</sup> Additional declines of 10 percent to 15 percent from the fall of 2008 to mid-2009 are predicted.<sup>16</sup> Those declines have resulted in an estimated 12 million homeowners owing more on their mortgage than their home is worth, a significant increase from 4.1 million homeowners in 2007.<sup>17</sup>

The rising numbers of foreclosures and the decline in housing values have resulted in a variety of proposed legislative fixes, ranging from state moratoriums on foreclosure filings to permission for bankruptcy court judges to write down principal balances on debtors' loans. None of the measures gained significant momentum until July 26, 2008, when the Senate passed amended bill H.R. 3221, the Housing and Economic Recovery Act of 2008 (HERA). The president signed the bill on July 30, 2008.

HERA includes several sections intended to reduce the rising tide of foreclosures. It modernizes the Federal Housing Administration's (FHA) operations;<sup>18</sup> establishes the HOPE for Homeowners Program (HOPE program), which will provide federal insurance when lenders voluntarily write down the principal balance owed on mortgages; and amends the Truth in Lending Act to insulate some servicers from potential litigation risk if they agree to modify principal amounts due on mortgage loans under the HOPE program.<sup>19</sup>

The purpose of this article is to describe key provisions of the HOPE program and examine the likelihood that it will indeed reduce foreclosures and stabilize the mortgage market over the three years during which the program is effective.

## II. HOPE Program

Title IV of HERA, which is entitled "HOPE for Homeowners Act of 2008," amends Title II of the National Housing Act.<sup>20</sup> Its purpose is to assist homeowners in avoiding foreclosures, support long-term sustainable homeownership, stabilize and provide confidence in the mortgage markets, and provide "servicers of delinquent mortgages with additional methods and approaches to avoid foreclosure."<sup>21</sup> The HOPE program, as it was enacted, sought to accomplish those purposes through a voluntary program in which the first mortgage is modified or refinanced and the principal balance is reduced to no more than 90 percent of the market value of the

property it secures.<sup>22</sup> In return, the first mortgage lienholder is eligible for FHA insurance on the reduced principal amount, which in effect insulates the lienholder from future declines in housing prices or risk of loss through foreclosure. The HOPE program faces many obstacles that stem from HERA's voluntary nature and from the securitization of many of the residential mortgages that might be eligible for participation in the program. On October 3, 2008, the HOPE program was amended by the Emergency Economic Stabilization Act of 2008 (EESA), in an effort to broaden the program's reach.<sup>23</sup>

Unfortunately, the HOPE program is not likely to have a significant effect on the rising number of foreclosures or in stabilizing the mortgage market. HERA limits the FHA's authority to insure mortgages under the HOPE program to a total aggregate principal amount of \$300 billion of mortgages during the period beginning October 1, 2008, and ending September 31, 2011.<sup>24</sup> The Congressional Budget Office (CBO) estimates that only 400,000 borrowers will refinance under the HOPE program.<sup>25</sup> Given the current rates of default, a predicted three million in 2008 alone, the HOPE program could help only a fraction of the homeowners who default before the program ends in 2011.<sup>26</sup> The sheer number of anticipated defaults and the increasing numbers of people who owe more on their mortgages than the value of their homes will make it difficult for the HOPE program to stabilize housing prices or significantly reduce the number of foreclosures. Unfortunately, even more barriers to success exist. Each will be discussed in detail after a brief review of the HOPE program's requirements and function.

To participate in the HOPE program, a borrower

1. must not be intentionally in default,<sup>27</sup>
2. must not have provided false information to obtain a mortgage that is eligible for the HOPE program,<sup>28</sup>
3. as of March 1, 2008, must have had or thereafter is likely to have, due to the terms of the mortgage being reset, a mortgage debt-to-income ratio greater than 31 percent,<sup>29</sup>
4. must not be able to afford his or her mortgage payments,<sup>30</sup>
5. must have entered into the mortgage on or before January 1, 2008,<sup>31</sup> and
6. must only have an ownership interest in one residence that is the borrower's principal residence and secures the mortgage debt.<sup>32</sup>

The HOPE program severely restricts the provisions that may be included in loans insured by the program.<sup>33</sup> Loans must have terms of at least thirty years,<sup>34</sup> may not exceed the reasonable ability of the borrower to make payments,<sup>35</sup> and must have a fixed interest rate.<sup>36</sup> Initially, the HOPE program required the principal balance of the loan to be no more than 90 percent of the market value of the property but that provision was amended to permit a higher percentage.<sup>37</sup> Lenders are permitted to charge a 1 percent origination fee.<sup>38</sup> Interest rates, although required to be fixed, are to be commensurate with the market rate for comparable loans.<sup>39</sup> The

existing senior lender/servicer must agree to waive all penalties for prepayment or refinancing and any fees and penalties relating to default or delinquency<sup>40</sup> and release its lien on the property in return for receiving the proceeds from the program mortgage. Finally, all subordinate lienholders must agree to have their interest extinguished upon refinancing with the program.<sup>41</sup>

In return for a future equity position, borrowers must agree to share that equity, as well as any appreciation in their home, with the FHA.<sup>42</sup> Specifically, borrowers must share any equity created by the HOPE program if they sell or refinance their home. After the first year of the loan, 90 percent of any equity created by sale or refinancing belongs to the FHA, and 10 percent belongs to the borrower. This declines to a shared equity in the fifth year and thereafter.<sup>43</sup> Borrowers must also equally share with the FHA, upon sale or disposition, the appreciation in their home that occurred after the date the mortgage was insured under the HOPE program.<sup>44</sup> If a second lienholder had an interest extinguished during the refinancing, that secondary lienholder may also share in the appreciation of the property or receive a cash payout instead.<sup>45</sup>

In addition to forgiving a portion of the principal amount due, the existing lienholder must also pay the initial 3 percent FHA insurance premium on the new HOPE loan.<sup>46</sup> For the life of the loan, borrowers must continue to pay an additional 1.5 percent annual premium based on the remaining principal balance of the mortgage.<sup>47</sup> Because the FHA insures the entire balance of the new principal amount, in effect, the lienholder is insulated from further market risk if home prices go down and foreclosure results. Borrowers also agree not to get a second mortgage on their home during the first five years of the mortgage, except those loans that ensure that the property meets maintenance standards.<sup>48</sup> Second liens related to property maintenance may be permitted only if the loan does not reduce the value of the government's equity, and if the total of the second loan combined with the first mortgage does not exceed 95 percent of the home's value.<sup>49</sup>

The HOPE legislation gives the program's board of directors<sup>50</sup> the ability to "establish requirements and standards for the program" and prescribe such regulations and ... guidance as may be necessary or appropriate to implement such requirements and standards."<sup>51</sup> The HOPE board issued rules establishing the core requirements for the program on October 6, 2008.<sup>52</sup> The rules took effect without a public comment period upon their publication in the *Federal Register* and will be codified at 24 C.F.R. Part 4001.

The HOPE program is voluntary. Neither first mortgage holders nor subordinate lienholders are required to participate. Lienholders that believe that they will benefit from reducing the principal balance of the mortgage rather than foreclosing will participate. Because many mortgage loans are sold by their originators and securitized, entities servicing those loans for the investors that own them will have to determine if loan modifications under the HOPE program are in the best interest of those investors.<sup>53</sup>

To encourage mortgage servicers to participate, HERA also amended the Truth in Lending Act<sup>54</sup> by adding a new section that defines the fiduciary duty of a servicer for a pooled residential mortgage where the duty is not established by contract with the servicer.<sup>55</sup>

### III. Obstacles to Success

The HOPE program faces substantial barriers to accomplishing its goals, including the program's voluntary nature, the number of loans that have been securitized, and the role of the servicer with securitized mortgage pools. CBO estimates that nine million homeowners with outstanding sub-prime and Alt-A loans could qualify for the HOPE program.<sup>56</sup> Out of those nine million, CBO estimates that the HOPE program will only assist an estimated 400,000 borrowers and a recent FHA estimate predicts that only 13,300 borrowers will be assisted in the first year of the HOPE program.<sup>57</sup>

Because participation in the HOPE program is voluntary, all participants must determine that they can derive a benefit from the program before consenting to participate. The borrower, the lienholder (or the loan servicer on behalf of the lienholder), and subordinate lienholders must also agree upon the terms of their participation. Each of these parties has unique issues and circumstances that will affect the decision, as discussed below.

#### *A. Borrowers May Not Be Eligible or Willing to Participate*

Borrowers (and their lenders) may not initially know if they are eligible for the HOPE program. The legislation contains requirements for borrower eligibility, but one of the requirements needs further clarification—despite publication of further guidance and rules.<sup>58</sup> The program requires borrowers to certify that they have not intentionally defaulted on a mortgage eligible for the HOPE program (or any other debt). HERA criminalizes a willful false statement concerning that matter. The program regulations define intentional default as when (1) a borrower knowingly failed to make payment on the mortgage or debt, (2) a borrower had available funds at the time payment was due that could have paid the mortgage or debt without undue hardship, and (3) the debt was not the subject of a bona fide dispute.<sup>59</sup> Because undue hardship is not defined and a numerical standard such as a total debt to gross income ratio is not employed, borrowers (and lenders) may not be sure when an intentional and disqualifying default has occurred. Have borrowers intentionally defaulted because they chose to pay private school tuition for their children instead of the mortgage? What about health insurance? A luxury car payment? A contribution to a 401(k) plan? A credit card payment in excess of the monthly minimum?

Even if a mortgage holder or servicer determines that the borrower is eligible to participate in the HOPE program, the delinquent borrower may be difficult to find. Servicers report that they engage in a variety of tactics to get borrowers to return phone calls, including sending free cell phones to borrowers to encourage them to call back.<sup>60</sup> More than half of borrowers

in foreclosure proceedings have no contact with their lender.<sup>61</sup> One lender reported that it attempted to help 300 seriously delinquent homeowners avoid foreclosure, but only thirty-eight responded.<sup>62</sup> Unfortunately, although approximately 20 percent of homeowners believe that nothing will happen after missing three or more payments,<sup>63</sup> interest rates charged under the HOPE program may become unaffordable after repeated months of default cause further damage to a borrower's credit score.

Even if borrowers are eligible for the program and engaged in discussions with their lenders, will they understand and be able to assess whether the HOPE program provides a better alternative to foreclosure for them? Although borrowers receive a future equity position in their home, the cost of participating in the HOPE program is significant. Participation requires that borrowers not only accept the loss of value in their home but also understand that any future appreciation in value must be shared equally with FHA when the property is sold.<sup>64</sup> Borrowers must also pay market rate interest, a one percent origination fee, and an annual premium of 1.5 percent for FHA insurance. The FHA has already acknowledged that HOPE loans will have higher interest rates because of the distressed nature of the borrowers entering the HOPE program. Higher interest rates will adversely affect the affordability of HOPE loans.<sup>65</sup> Some borrowers may decide that the program is too expensive and choose to walk away from their current home after purchasing a smaller, less expensive home.<sup>66</sup>

Understandably, default rates clearly depend on the amount of equity homeowners have in their home.<sup>67</sup> Given that borrowers in the HOPE program will initially have no equity, a substantial number of participants in the HOPE program may end up in default. One study found that a significant number of borrowers, approximately 40 percent, who entered into a forbearance agreement or modification re-defaulted within one year.<sup>68</sup> Other industry participants have pegged re-default rates at 30 percent to 45 percent.<sup>69</sup> One rating agency found that 20 percent of loans that had been modified in 2006 had re-defaulted in the first six months of 2007.<sup>70</sup> CBO has predicted that about one-third of the HOPE program loans will end in default.<sup>71</sup> The FHA acknowledges that developing workable underwriting standards for distressed borrowers is challenging and that while more lenient standards will increase participation in the HOPE program, more lenient standards will also result in higher defaults.<sup>72</sup> Both regulators and industry participants agree that re-defaults are less likely if loan modifications result in loans that are truly affordable for borrowers.<sup>73</sup>

#### *B. Securitization and Loan Servicers May Block Participation*

The majority of subprime mortgage loans are securitized and serviced by entities that did not originate the loan.<sup>74</sup> Servicers typically collect mortgage payments and pay them to the investor or lender that holds the mortgage, manage escrow funds for taxes and insurance, and engage in collection and loss mitigation efforts when borrowers default. For more than a year

before the creation of the HOPE program, servicers had been encouraged to engage in appropriate loan modifications to ensure long-term affordability for borrowers.<sup>75</sup> Nevertheless, servicers failed to modify loans.<sup>76</sup> According to a September 2007 survey conducted by Moody's Investment Services, sixteen servicers representing 80 percent of the subprime market had modified only 1 percent of loans that experienced interest rate resets in early 2007.<sup>77</sup> Servicers rely heavily on repayment plans<sup>78</sup> instead of modifications to assist borrowers in trouble.<sup>79</sup> Servicers also are relying on extending the initial interest rate on adjustable rate mortgages (ARMs) for up to five years.<sup>80</sup> Unfortunately, the effectiveness of techniques such as repayment or forbearance agreements is decreasing.<sup>81</sup>

A brief explanation of the securitization process is necessary to understand the important role that servicers play in determining whether a willing and eligible borrower can participate in the HOPE program. Before securitization became prevalent, most borrowers dealt with lenders that originated their own loans and held them on their books as assets until maturity. Lenders that held those loans were careful to use appropriate underwriting standards to minimize their risk. As the subprime market grew, originators of subprime mortgages quickly learned that sale and securitization of those loans resulted in a quick return of capital, permitting them to make even more loans and escape the consequences of lax underwriting.<sup>82</sup> Generally, subprime mortgage originators made loans and transferred those loans to a separate third party. The third parties combined those loans into a large pool and sold to investors the rights to receive payments due under the mortgages making up the pool. The process of pooling those mortgages and selling interests in the payments due is known as securitization.

Securitization converts individual mortgages (and the rights to receive payments on those mortgages) into mortgage-backed securities. Usually, the entity securitizing the loan tries to isolate the loans from the lender or originator in order to protect investors if the lender or originator files for bankruptcy. This is done by selling the loans to a special purpose vehicle (SPV) that is separate from the lender or originator. Such a sale also erects a barrier to borrowers seeking to pursue claims of inappropriate lending practices because the purchasers may become "holders in due course" and thus immune to suit.<sup>83</sup> The loans are then transferred to another SPV, usually a trust, that ultimately holds the loans and is the issuer of the mortgage-backed securities.

The issuer, with the help of an investment bank, divides different payment streams from the mortgages into different types of securities with different risks. The different types of securities are called tranches. The investment bank usually determines the structure of the tranches by determining what attributes will appeal to investors.<sup>84</sup> The most senior tranches are securities with the least risk and usually are paid first. The lowest tranche usually has the most risk and is the first group of investors to experience losses. Some of the tranches may receive interest payments, and some may receive principal payments. Some tranches might be structured to receive



prepayment penalties.<sup>85</sup> The trust that holds the loans is ultimately responsible for collecting moneys due from the mortgages and distributing those funds to the investors. The trust that owns the loans usually has no employees and instead retains servicers to collect interest, principal, and fees and to engage in loss mitigation efforts. Some pools may have one or more entities engaged in servicing the loans. For example, some trustees engage a master servicer who will then engage a servicer who may, in turn, engage subservicers.

Securitization directly impacts the ability of borrowers to have their loans modified or refinanced under the HOPE program. Only approved FHA lenders who volunteer for the HOPE program may originate HOPE loans.<sup>86</sup> The special purpose vehicles that own securitized mortgages as well as many of their servicers do not have origination capability and are not approved FHA lenders.<sup>87</sup> If those servicers want defaulting borrowers to participate in the HOPE program, they will have to rely upon FHA-approved lenders to assist those borrowers and originate the HOPE loans.

Even if a servicer has origination capability through an approved FHA lender participating in the program, the ability of borrowers to participate in the HOPE program can be affected in other ways. First, servicing agreements contain clauses that limit the ability of the servicer to enter into loan modifications.<sup>88</sup> Second, because loan modifications can result in a reduction of the interest rate, principal, or term, they may result in a benefit to one investor and a loss to another, thereby exposing the servicer to claims of breach of contract and fiduciary duty.<sup>89</sup> Third, according to industry reports, servicers are simply overwhelmed with the number of defaults and do not have the specially trained staff to modify loans. Finally, the current structure of servicer compensation makes it unlikely that servicers will engage in large numbers of loan modifications under the HOPE program.

Because loan modifications have a potentially significant impact on investment performance, servicing agreements contain clauses that limit the ability of the servicer to enter into loan modifications.<sup>90</sup> An estimated one-third of loan pools restrict the number of loans that may be modified.<sup>91</sup> A typical threshold is 5 percent of the pool.<sup>92</sup> Some pools do not permit any modifications.<sup>93</sup> Other pools limit the ability to extend the term of the underlying loans.<sup>94</sup> Some securitization deals give investors the right to demand that borrowers go to foreclosure if their interest will be extinguished through a modification.<sup>95</sup> The servicing agreement may also require the servicer to wait until the borrower is thirty or more days delinquent before it can modify the loan.<sup>96</sup> Still other servicing agreements require the loan to be either in default or reasonably foreseeable to default before a modification may be made.<sup>97</sup>

Even if the servicing agreement contains no specific limitation on loan modifications, the language regarding the servicer's ability to modify loans may be so vague that servicers are unlikely to test the limits of their authority.<sup>98</sup> Many servicing agreements contain language requiring the servicer to perform its obligations in the best interest of the investors or in the same manner that the servicer would service its own loans.<sup>99</sup> Unfortunately,

there is no recognized method or process for gaining investor approval for amendment of the servicing agreement; and even if such a process existed, not all investors would agree.

Servicers are also unlikely to engage in substantial modifications or accept proceeds of a HOPE program refinance and release their liens because investors may second-guess whether such actions resulted in a benefit to a particular investor or tranche or to the pool as a whole.<sup>100</sup> Servicers may also be second-guessed because of potential conflicts of interest that arise if they have a residual ownership interest in the pool.<sup>101</sup> Because the structure and characteristics of each tranche's interest are based upon the original terms of the loans in the pool, trustees and servicers have limited discretion to modify the terms of individual loans within a pool when faced with borrowers either in default or about to default. Each modification of a loan may result in an increase in income to one investor and a decrease to another. This requires a trustee to decide which tranche should receive more money, a decision that leaves the trustee exposed to litigation.<sup>102</sup> A loan modification that reduces income to investors may also result in litigation.<sup>103</sup> Waiving a prepayment penalty when a loan is refinanced may also result in litigation by investors.

In an unstable housing market, it may be difficult to determine which option will result in higher recovery for investors.<sup>104</sup> Some servicers may resort to the safest course, i.e., foreclosure or forbearance plans, which, when unsuccessful, ultimately result in foreclosure.<sup>105</sup> In an effort to address these types of concerns, various industry participants have issued loan modification guidelines that focus on determining that the net present value of the payments on the modified loan is likely to be greater than the anticipated recovery from foreclosure.<sup>106</sup> Some lenders believe that a payment with similar affordability may be achieved through interest rate reductions and term extensions. Because a similar affordable payment could be achieved without a reduction in principal, the lender/investor would retain the opportunity to share in the appreciation when values rebound.<sup>107</sup>

The capacity of servicers to engage in loan modifications is also an issue.<sup>108</sup> Increasing defaults expand the workload of servicers, and the rapid rate at which the defaults have occurred has contributed to those capacity problems.<sup>109</sup> In fact, servicers are having difficulty hiring skilled staff and finding outside vendors to assist.<sup>110</sup> Some servicers have had to increase their collection and loss mitigation staff by anywhere from 200 percent to 500 percent.<sup>111</sup> Because all servicers are facing a simultaneous need for larger capacity, their inability to engage in loan modifications is readily apparent. The Foreclosure Prevention Working Group, a group of state officials, believes that loss mitigation departments are overwhelmed and reported in April 2008 that seven out of ten delinquent borrowers were not in line to receive any kind of loan modification.<sup>112</sup>

Finally, servicing agreements provide a financial disincentive for servicers to engage in loan modifications that are estimated to cost between \$500 and \$1,000 per loan, a cost that servicers must bear.<sup>113</sup> Servicers

also rely upon earning other fees that are directly impacted by the HOPE program. Most servicing agreements provide for a servicing fee calculated as a percentage of the unpaid principal balance. For prime loans, the fee is typically twenty-five basis points. For subprime pools, the servicing fee is typically fifty basis points.<sup>114</sup> Because the HOPE program requires the principal balance of the loan to be reduced to 90 percent of the market value, the program provides a disincentive because it lowers servicers' revenues. The HOPE program also requires fees relating to defaults, including late charges, to be waived.<sup>115</sup> Most servicing agreements typically provide that fees relating to late payments and defaults may be retained by the servicer.<sup>116</sup>

The HOPE program's impact on servicer behavior will likely be minimal. Securitization requires that servicers act in the best interests of the investors.<sup>117</sup> Financial survival requires that servicers earn profits. The HOPE program does not provide any financial incentives to servicers. Because an estimated 70 percent to 75 percent of outstanding first lien mortgages have been securitized,<sup>118</sup> it is unlikely that many of those loans will be modified or refinanced under the HOPE program.

### *C. Second Lienholders Are Likely to Block Participation*

The HOPE program requires all subordinate liens to be extinguished as a condition of participation in the program. CBO estimates that 40 percent of all subprime and Alt-A loans have second liens.<sup>119</sup> It is very unlikely that borrowers with second liens will be able to participate in the HOPE program. Subordinate lienholders may refuse to extinguish their liens, a prerequisite for participation in the program, believing that the borrower's ability to make payments or the value of the home will be greater in the future.<sup>120</sup> Although second lienholders might be persuaded to accept loan modifications outside of the HOPE program that preserve their interest, they are not likely to participate in a program that requires that their liens be released. Although subordinate lienholders owed more than \$2,500 participating in the HOPE program may receive a share of future appreciation or a cash payout, lienholders owed less receive nothing under the program.<sup>121</sup> The amount of the shared appreciation, 9 or 12 percent of future appreciation at a future date not yet determined, may not be enough to persuade junior lienholders to waive their interests.<sup>122</sup> Neither the EESA or the regulations provide guidance on what the payments in lieu of a shared appreciation interest should be. If second (and first) lienholders perceive that foreclosure is imminent, participation may be more likely.<sup>123</sup> If those second liens are securitized, for the same reasons discussed above, participation is unlikely.

### *D. Additional Issues*

The HOPE program presents additional issues other than those arising from securitization and lack of voluntary participation. One of those issues arises from the wrong kind of participation by lenders, i.e., adverse selection. More than one regulator has expressed concern that lenders may choose those loans that are the least likely to succeed for the HOPE

program.<sup>124</sup> Lenders engaging in adverse selection might willingly write down the principal balance of a loan that is not likely to succeed in return for receiving a loan that is fully federally insured against default.<sup>125</sup> The HOPE program legislation directed the HOPE board to establish standards and policies to protect against adverse selection.<sup>126</sup> The legislation does not provide guidance as to what those standards should be other than stating that higher-risk loans may have to "demonstrate payment performance for a reasonable period of time prior to being insured under the program."<sup>127</sup> Regulations adopted for the program have interpreted that legislative directive to require that the borrower make one payment within 120 days after the closing of the program mortgage.<sup>128</sup> The payment may not be made by the lender or escrowed at closing.

Finally, permitting subordinate lienholders to participate in future appreciation with the FHA but not permitting existing senior mortgage holders to share in that appreciation will limit participation in the HOPE program. Senior mortgage lenders and servicers that can avoid a principal writedown and achieve affordable payments through interest rate reductions and term extensions have little incentive to participate.<sup>129</sup>

#### IV. Conclusion

The HOPE program is too little, too late for the many homeowners who faced foreclosure last year and the three million homeowners who are predicted to default this year. Given the significant barriers to success, it is unlikely that the program will prevent a significant number of foreclosures or that it will stabilize the mortgage market. Providing help to 400,000 homeowners is simply not enough, given the magnitude of the problem. The housing market is plagued by 12 million homeowners who owe more than their homes are worth. The problem is compounded by the record number of defaults resulting in foreclosures that lead to even further declines in home values. More comprehensive legislative solutions are sorely needed, and those solutions need to address the current market conditions and the lack of regulation that led to them.

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1. PRESIDENT'S WORKING GROUP ON FIN. MKTS., POLICY STATEMENT ON FINANCIAL MARKET DEVELOPMENTS (2008), available at [www.treasury.gov/press/releases/reports/pwgpolicystatemkkturmoil\\_03122008.pdf](http://www.treasury.gov/press/releases/reports/pwgpolicystatemkkturmoil_03122008.pdf); Peter Coy et al., *The Housing Abyss*, *Bus. Wk.*, July 7, 2008, at 32.

2. Coy, *supra* note 1, at 32. Subprime loans are loans that are made to borrowers with low credit scores or who have credit history issues. Alt-A loans are usually made to people who have a better credit profile than subprime borrowers but are made with little or no documentation of the borrower's income. Alt-A loans also include loans with low down payments, interest-only loans, and loans with escalating payments. In this article, references to subprime loans include Alt-A loans unless noted.

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4. *Id.*; DANIELLE DiMARTINO & JOHN V. DUCA, FED. RESERVE BANK OF DALLAS, THE RISE AND FALL OF SUBPRIME MORTGAGES 9 (Nov. 2007), available at [www.dallasfed.org/research/ecllett/2007/el0711.html](http://www.dallasfed.org/research/ecllett/2007/el0711.html).

5. Kelly D. Edmiston & Roger Zalneraitis, *Rising Foreclosures in the United States: A Perfect Storm*, ECON. REV. 115, 123 (2007), available at [www.kc.frb.org/PUBLICAT/ECONREV/PDF/4q07Edmiston.pdf](http://www.kc.frb.org/PUBLICAT/ECONREV/PDF/4q07Edmiston.pdf).

6. Allison Pyburn, *Industry: Let Capital Markets Solve Subprime Fiasco*, ASSET SECURITIZATION REP., Mar. 19, 2007; see also Warren Kornfeld, *Role of Securitization in Subprime Mortgage Market Turmoil*, CQ CONG. TESTIMONY, Apr. 17, 2007.

7. Edmiston & Zalneraitis, *supra* note 5, at 129.

8. DiMARTINO & DUCA, *supra* note 4.

9. *Id.*

10. Amy Merrick, *Mortgage Insurers Raise Bar—Potential Home Buyers Face Stricter Standards, Higher Costs*, WALL ST. J., July 15, 2008, at A1.

11. *Id.*

12. FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS (July 15, 2008), available at [www.federalreserve.gov/boarddocs/hh/2008/july/FullReport.pdf](http://www.federalreserve.gov/boarddocs/hh/2008/july/FullReport.pdf).

13. *Rising Household Debt, Defaults Straining US Economy*, BUS. WIRE, July 23, 2008.

14. *Id.*

15. Michael Corkery & James R. Hagerty, *Continuing Vicious Cycle of Pain in Housing and Finance Ensnarers Market*, WALL ST. J., July 14, 2008, at A2.

16. Ruth Simon & Michael Corkery, *The Financial Crisis: Next Steps: No Quick Fix for Housing Prices*, WALL ST. J., Oct. 15, 2008, at A3.

17. *Id.*; *Rising Household Debt*, *supra* note 13. It should also be noted that housing price declines are highest where rapid appreciation was the greatest during the recent period of expansion. Expectations of further price declines may make buyers reluctant to purchase until the market shows signs of stabilizing.

18. Although a detailed overview of the FHA Modernization Act of 2008 is beyond the scope of this article, that portion of the legislation increases the loan limit that the FHA is permitted to insure to 115 percent of area median home prices (capped at \$625,000) and prohibits down payment assistance from the seller or another interested party. The FHA Modernization Act also includes a moratorium on risk-based pricing of FHA insurance premiums until September 30, 2009. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2133, 122 Stat. 2654 [hereinafter HERA]. The FHA started the practice of risk-based premium pricing shortly before the passage of this legislation. The FHA instituted risk-based premium pricing because its historic flat price structure of 1.5 percent of the loan balance initially and 0.5 percent per year was inequitable for borrowers and placed the FHA insurance fund at risk. Press Release, U.S. Dep't of Hous. & Urban Dev., Bush Administration to Implement FHASecure Expansion Using Fair, Flexible Premium Pricing (May 8, 2008), available at [http://portal.hud.gov/portal/page?\\_pageid=73,1828503&\\_dad=portal&\\_schema=PORTAL](http://portal.hud.gov/portal/page?_pageid=73,1828503&_dad=portal&_schema=PORTAL). The risk-based premiums announced in that press release ranged from 1.25 percent to 2.25 percent on the initial loan amount. Both initial and annual premiums were limited by statute to 2.25 percent and 0.55 percent, respectively.

19. HERA also provides \$180 million for housing counseling efforts for homeowners in distress and \$3.9 billion to local governments for the redevelopment

of abandoned and foreclosed homes. It also provides additional protection for members of the Armed Forces, National Guard, and Reserves by requiring the Secretary of Defense to establish a credit and mortgage counseling service for those people who are returning from service on active duty abroad. HERA § 2202. It also amends the Servicemembers Civil Relief Act, 50 U.S.C. app. § 501 (2000), by extending the time periods when a service member may request that a foreclosure action be stayed or proscribed from ninety days to nine months after a period of military service. HERA § 2203.

20. 12 U.S.C. § 1701 (2006). Title II of the National Housing Act established the Federal Home Administration Insurance Program. The HOPE program is codified at 12 U.S.C. § 1715z-23.

21. HERA § 1402, National Housing Act § 257(b).

22. The FHA introduced another voluntary program called FHASecure in September 2007, which initially met with limited success due to its restrictions on eligibility. FHASecure was originally introduced to assist borrowers who became delinquent after low teaser rates on their adjustable rate mortgages (ARM) reset to substantially higher rates. Initially, borrowers who were delinquent before their interest rates reset were not eligible for the program. One industry analyst estimated that only 6 percent of ARMs that had reset were eligible for FHASecure; another estimated that only 44,000 borrowers could be helped by the program. Kate Berry, *HUD Mulling How to Widen FHA Refi Net*, AM. BANKER, Feb. 19, 2008, at 1. Although the FHA has broadened the availability of the FHASecure loan to all borrowers, including those with conventional loans, borrowers who are delinquent on their mortgages are eligible only under limited circumstances. For information regarding eligibility to participate in the FHASecure program, see FHA's website and the FHA Refinance Programs Comparison Matrix, available at [http://portal.hud.gov/portal/page?\\_pageid=73,1827972&\\_dad=portal&\\_schema=PORTAL](http://portal.hud.gov/portal/page?_pageid=73,1827972&_dad=portal&_schema=PORTAL).

23. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:h1424enr.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h1424enr.txt.pdf). Prior to the amendments contained in the Emergency Economic Stabilization Act of 2008, the FHA issued Mortgagee Letter 2008-29 on October 1, 2008, entitled *Hope for Homeowners Origination Guidance*, available at [http://portal.hud.gov/portal/page?\\_pageid=73,1825893&\\_dad=portal&\\_schema=PORTAL](http://portal.hud.gov/portal/page?_pageid=73,1825893&_dad=portal&_schema=PORTAL).

24. HERA § 1402, National Housing Act § 257(m), (r).

25. CONG. BUDGET OFFICE, FEDERAL HOUSING FINANCE REGULATORY REFORM ACT OF 2008, at 8 (June 9, 2008), available at [www.cbo.gov/ftpdocs/93xx/doc9366/Senate\\_Housing.pdf](http://www.cbo.gov/ftpdocs/93xx/doc9366/Senate_Housing.pdf).

26. If a median home value of \$206,200 is used as the median value for a typical loan insured under the HOPE program, the HOPE program could assist 1.45 million borrowers, less than half of whom are predicted to default on their first mortgage this year. CBO estimates that 2.2 million subprime mortgages will default during the time that the HOPE program is in operation (October 1, 2008, through September 20, 2011). *Id.*

27. HERA § 1402, National Housing Act § 257(e)(1)(A).

28. *Id.*

29. HERA § 1402, National Housing Act § 257(e)(1)(B); EESA § 124. As originally enacted, the HOPE program was only available to borrowers who had a 31 percent mortgage debt-to-income ratio as of March 1, 2008.

30. HERA § 1402, National Housing Act § 257(s)(3)(A)(ii).

31. HERA § 1402, National Housing Act § 257(s)(3)(B).

32. HERA § 1402, National Housing Act § 257(e)(11). The residence must be a single family residence. 24 C.F.R. § 4001.08(a).

33. HERA § 1402, National Housing Act § 257(s)(3) defines *eligible mortgage* as one for a principal residence that was originated before January 1, 2008, and one that the borrower cannot afford.

34. HERA § 1402, National Housing Act § 257(e)(5)(B).

35. HERA § 1402, National Housing Act § 257(e)(2).

36. HERA § 1402, National Housing Act § 257(e)(5)(A).

37. Emergency Economic Stabilization Act of 2008, § 124. A higher percentage may be determined by the board of directors for the HOPE program.

38. Mortgagee Letter, *supra* note 23, at 6. The legislation provided that reasonable origination fees could be charged. HERA § 1402, National Housing Act § 257(j)(1).

39. HERA § 1402, National Housing Act § 257(j)(2).

40. Penalties and charges relating to default, prepayment, or refinancing are required to be waived. HERA § 1402, National Housing Act § 257(e)(3).

41. HERA § 1402, National Housing Act § 257(e)(4). The program requires that all holders of outstanding liens agree to accept the proceeds of the newly insured loan as payment in full of all indebtedness under the eligible mortgage, and all encumbrances relating to the eligible mortgage have to be removed. The board is required to formulate standards and policies to permit subordinate lienholders to share in any future appreciation of the property, which is discussed below.

42. The shared appreciation and shared equity will be evidenced by notes and mortgages recorded at the loan closing. The shared equity mortgage will be in second priority position and the shared appreciation mortgage will be in third position. Mortgagee Letter, *supra* note 23, at 10–11. While the difference between the home's market value and the principal balance of the loan is equity, the borrower cannot access that equity in the first year. 24 C.F.R. § 4001.18; HERA § 1402, National Housing Act § 257(k)(1).

43. HERA § 1402, National Housing Act § 257(k)(1).

44. HERA § 1402, National Housing Act § 257(k)(2).

45. HERA § 1402, National Housing Act § 257(e)(4)(B). The legislation as originally enacted only permitted subordinate lienholders to receive a future share of appreciation. The amendments contained in § 124 of the Emergency Economic Stabilization Act of 2008 permit a cash payment in lieu of shared future appreciation.

46. 24 C.F.R. § 4001.203(b). In essence, the existing lienholder will take at least a 13 percent write-down of the principal value of the eligible mortgage. For example, if the eligible mortgage has a principal balance of \$200,000 and the market value is now \$160,000, the most that the new principal amount could be is 90 percent of that amount (\$144,000), and the lender would also have to pay the initial 3 percent premium (\$4,800). In this hypothetical example, the lienholder would experience a \$44,800 loss. Origination fees and expenses could increase that loss.

47. HERA § 1402, National Housing Act § 257(i)(2).

48. Loans may not be for routine maintenance or cosmetic repairs and must preserve or increase the property's value. See 24 C.F.R. § 4001.303 for a complete list of prohibitions and requirements.

49. 24 C.F.R. § 4001.303.

50. The board is composed of the Secretary of Housing & Urban Development, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, or their designees. HERA § 1402, National Housing Act § 257(s)(2).

51. HERA § 1402, National Housing Act § 257(c)(1). The HOPE program also requires the board to conduct a study of the need and efficacy of an auction or bulk refinancing system to facilitate refinancing of existing residential mortgages into mortgages insured under the HOPE program. The board is required to submit a report reflecting the results of the study to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs within sixty days after the enactment of the legislation. HERA § 1402, National Housing Act § 257(f).

52. Hope for Homeowners Program: Program Regulations, 73 Fed. Reg. 58418 (Oct. 6, 2008).

53. A detailed explanation of the securitization process is beyond the scope of this article. For further information, see Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 *FORDHAM L. REV.* 2039 (2007); Christopher L. Peterson, *Predatory Structured Finance*, 28 *CARDOZO L. REV.* 2185 (2007); *Subprime Residential Mortgage Securitizations: Frequently Asked Questions*, MOODY'S INVESTOR SERVS., Apr. 19, 2007; FED. RESERVE BANK OF S.F., *supra* note 3.

54. 15 U.S.C. § 1601 (2006).

55. HERA § 1403, National Housing Act § 129A. The section is entitled Fiduciary Duty of Servicers of Pooled Residential Mortgages.

56. CONG. BUDGET OFFICE, *supra* note 25, at 8.

57. *Id.*; E. Scott Reckard, *Mortgages: Relief Program Gets Few Takers*, L.A. TIMES, Nov. 5, 2008, at C1.

58. Guidance issued by the FHA states that borrowers need not be in default to participate and that borrowers who are in bankruptcy may participate. Mortgage Letter, *supra* note 23, at 1. To be eligible, borrowers must have made a minimum of six full payments during the life of the existing senior mortgage. *Id.*

59. 24 C.F.R. § 4001.07.

60. William Launder, *Loss Mitigation: The View from the Trenches*, AM. BANKER, Oct. 12, 2007, at 4a.

61. FREDDIE MAC, FORECLOSURE AVOIDANCE RESEARCH 2 (2005), available at [www.freddiemac.com/service/msp/pdf/foreclosure\\_avoidance\\_dec2005.pdf](http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf).

62. Lew Sichelman, *Compassionate Servicing*, MORTGAGE BANKING, Feb. 1, 2001, at 16.

63. FREDDIE MAC, FORECLOSURE AVOIDANCE RESEARCH II 7 (2008), available at [www.freddiemac.com/service/msp/pdf/foreclosure\\_avoidance\\_dec2007.pdf](http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2007.pdf).

64. 24 C.F.R. § 4001.120.

65. Brian D. Montgomery, CQ CONG. TESTIMONY, Sept. 17, 2008.

66. Coy, *supra* note 1, at 32.

67. Roberto Quercia & Michael A. Stegman, *Residential Mortgage Default: A Review of the Literature*, 3:2 J. HOUSING RES. 341 (1992), available at [www.fanniemae.foundation.org/programs/jhr/pdf/jhr\\_0302\\_quercia.pdf](http://www.fanniemae.foundation.org/programs/jhr/pdf/jhr_0302_quercia.pdf).

68. FITCH RATINGS, U.S. RESIDENTIAL MORTGAGE SPECIAL REPORT: CHANGING LOSS MITIGATION STRATEGIES FOR U.S. RMBS (June 4, 2007). The Fitch Report states that servicers have reported a re-default rate on loan modifications



in the 35 percent to 40 percent range, which the report acknowledges is based on the small number of modifications performed by servicers as of that date.

69. Ted Cornwell, *Experts Say High Re-Default Rates Inevitable*, NAT'L MORTGAGE NEWS, Apr. 21, 2008, at 3.

70. Mary McGarity, *A Tough Test*, MORTGAGE BANKING, May 1, 2008, at 28.

71. CONG. BUDGET OFFICE, *supra* note 25, at 10.

72. Montgomery, *supra* note 65.

73. Greg Zeeman, chief servicing officer of HSBC Consumer & Mortgage Lending, stated in a speech at SourceMedia's Second Annual Mortgage Servicing Conference that consumers receiving substantial relief are more likely to keep paying their modified loans than consumers with more modest modifications. Cornwell, *supra* note 69. Federal Reserve Board Chairman Ben Bernanke stated that a write-down that is sufficient will remove the risk to investors of additional write-downs as well as the risk of re-default.

74. FED. RESERVE BANK OF S.F., *supra* note 3, at 10.

75. FDIC Chairman Sheila Bair urged the industry to engage in automatic modifications for borrowers with resetting ARMs in June 2007. In April 2007, federal regulatory agencies issued a document entitled *Statement on Working with Mortgage Borrowers*, which was also intended to encourage loan modifications. In October 2007, a group of banks, servicers, and industry participants, at the urging of the Department of Housing and Urban Development (HUD) and the Department of the Treasury, formed the HOPE NOW Alliance. The alliance's initial mission was to explore methods of reaching at-risk borrowers, to improve communications between nonprofit housing counselors and servicers, and to consult with investors who own mortgages to enable counseling to be funded through servicing contracts. Press Release, HOPE NOW Alliance Created to Help Distressed Homeowners (Oct. 10, 2007), available at [www.fsround.org/hope\\_now/pdfs/AllianceRelease.pdf](http://www.fsround.org/hope_now/pdfs/AllianceRelease.pdf). As of July 2008, the HOPE Now Alliance reported that its servicers had completed approximately 686,000 loan modifications and 1.38 million repayment plans in the prior year. See [www.hopenow.com/upload/data/files/HOPE%20NOW%20Loss%20Mitigation%20National%20Data%20July07%20to%20July08.pdf](http://www.hopenow.com/upload/data/files/HOPE%20NOW%20Loss%20Mitigation%20National%20Data%20July07%20to%20July08.pdf). The HOPE Now Alliance has been the subject of criticism because of allegations that it inflated the numbers of modifications and repayment plans it has engaged in. Cheyenne Hopkins, *Dugan Hits Loan-Mod Reports as Overstated; OCC Cites Flaws in Previous Counts; OTS Report to Follow*, AM. BANKER, June 12, 2008, at 1.

76. Loan modifications are permanent changes to the interest rate, the principal amount due, or the term of the loan.

77. MOODY'S SUBPRIME MORTGAGE SERVICER SURVEY ON LOAN MODIFICATIONS (Sept. 21, 2007), available at [www.moodys.com](http://www.moodys.com). An update of that survey released on December 17, 2007, estimated that the number had only increased to 3.5 percent.

78. Repayment plans are not usually restricted by servicing agreements. Kate Berry, *The Trouble with Loan Repayment Agreements*, AM. BANKER, Jan. 9, 2008, at 1. Some servicing agreements place a limit on the time that a repayment plan may be in place.

79. Repayment plans have borrowers pay more each month to make up for prior defaults. Tara Twomey, *Foreclosure Prevention*, CQ CONG. TESTIMONY, Apr. 16, 2008.

80. McGarity, *supra* note 70.

81. FITCH RATINGS, *supra* note 68, at 6. Some industry participants believe that the use of repayment plans has kept default rates artificially low but that at the end of the repayment plan, the loan will still be in default or move into foreclosure. Berry, *supra* note 78.

82. For an excellent explanation of the role of securitization in the growth of predatory lending, see Engel & McCoy, *supra* note 53; Peterson, *supra* note 53.

83. For an explanation of how being a holder in due course protects investors from litigation, see Engel & McCoy, *supra* note 53, at 2053.

84. *Id.*

85. Kurt Eggert, *Role of Securitization in Subprime Mortgage Market Turmoil*, CQ CONG. TESTIMONY, Apr. 17, 2007.

86. 24 C.F.R. § 4001.05.

87. Kate Berry, *Refi-Program Previewers Raise Issues*, AM. BANKER, Aug. 19, 2008, at 1.

88. There have been numerous legislative efforts to insulate servicers from investor litigation if those servicers engage in widespread loan modifications. For instance, H.B. 5579 proposed to create a safe harbor for creditors, assignees, servicers, and securitizers of residential mortgages engaging in widespread loan modifications. The legislation is not likely to be enacted. *Mortgage Bankers Association Vice Chairman Story Testifies on Emergency Mortgage Loan Modification Act of 2008 Before House Panel*, U.S. FED. NEWS, Apr. 15, 2008. The Emergency Loan Modification Act of 2007, introduced by Rep. Brad Miller, also sought to protect servicers and banks from litigation if they pursued loan modifications.

89. In *Teachers Insurance & Annuity Ass'n of America v. Criimi Mae Services*, 2007 U.S. Dist. LEXIS 28279 (S.D.N.Y. Mar. 20, 2007), the court was confronted with both a breach of fiduciary duty claim and a breach of contract claim by investors in commercial mortgage-backed securities. The investors were parties to the pooling and servicing agreement and held certificates that entitled them to distributions of interest payments on the underlying commercial mortgages, which had prepayment penalties. An affiliate of the servicer owned certificates that entitled it to distributions of principal payments on the mortgages. The pooling and servicing agreement permitted affiliates to own such interests but required the servicer to perform its functions "in the best interest of and for the benefit of all of the Certificateholders" without regard to "the ownership of any Certificate by the Servicer, the Special Servicer or any Affiliate." *Id.* at \*5. The investors alleged that the servicer (and its affiliates) breached their contractual and fiduciary duties because the servicer modified a mortgage loan by waiving a prepayment period and penalty for one borrower who was experiencing financial difficulties. The servicer later sold the modified loan and treated the proceeds of the sale as repayment of principal. The investors alleged that the servicer had deprived them of their contractual right of protection from prepayment and caused them to forfeit their right to recover interest payments as well as impermissibly permitted the affiliate of the servicer to enjoy a greater return of principal. The court denied the defendants' motion to dismiss the claims of breach of contract and fiduciary duty.

90. An industry lobbyist responding to FDIC's suggestion that rates be frozen on ARMs warned that servicers could face investor suits because "when a servicer agrees with a customer to reduce a loan's interest rate or principal balance, the servicer is giving away the investors' money, not its own." Harry

Terris, *Across-the-Board Modifications Spark Objections*, AM. BANKER, Oct. 11, 2007, at 11.

91. Eggert, *supra* note 85.

92. Terris, *supra* note 90.

93. *Mortgage Bankers Association Vice Chairman Story Testifies*, *supra* note 88.

94. *Id.*

95. Neil J. Morse, *Damage Control*, MORTGAGE BANKING, Feb. 1, 2008, at 32.

96. Eggert, *supra* note 85.

97. The American Securitization Forum, an affiliate of the Securities Industry and Financial Markets Association that includes more than 375 market participants such as issuers, investors, servicers, rating agencies, and legal and accounting firms, issued *Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans* in June 2007, available at [www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles\\_060107.pdf](http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf).

98. Ruth Simon, *Digging Out of Delinquency—More Borrowers Fall Behind on Home Loans, Complicating Efforts to Work Out Solutions*, WALL ST. J., Apr. 11, 2007, at D1.

99. Karen Weaver & Katie Reeves, *Incentives and RMBS Servicer Performance*, TOTAL SECURITIZATION, June 8, 2007.

100. The statement of principles issued by the American Securitization Forum in June 2007 and an additional statement issued in December 2007 encouraged market participants to standardize all loan modification provisions in securitization documents as well as to develop guidance for identifying and managing investor conflicts arising from loan modifications. The December 2007 Statement is available at [www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf](http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf).

101. Weaver & Reeves, *supra* note 99.

102. Twomey, *supra* note 79; Eggert, *supra* note 85.

103. Stacy Kaper, *Agency Criticism May Spark Changes in Modification Bill*, AM. BANKER, Dec. 7, 2007, at 4.

104. Costs relating to a foreclosure, including legal fees, property management fees, and broker fees, may amount to as much as 40 percent of the property's value.

105. Tim Anschutz, *The Lowdown on Loan Modifications*, MORTGAGE BANKING, May 1, 2008, at 64.

106. *Statement of Principles*, *supra* note 97.

107. Molly Sheehan, CQ CONG. TESTIMONY, Sept. 17, 2008; Mary Coffin, CQ CONG. TESTIMONY, Sept. 17, 2008.

108. Industry participants have identified other potential difficulties with the HOPE program such as whether servicers, if they wish to participate in the program, have to be FHA-approved lenders or have origination capabilities. Berry, *supra* note 87, at 1.

109. McGarity, *supra* note 70.

110. Servicers' performance and financial strength are assessed by the rating agencies. One rating agency found that servicers were abandoning 9 percent to 10 percent of their incoming calls from borrowers. *Id.*

111. *Id.*

112. Emily Flitter, *In Focus: In Loan Mods, Process Isn't Quite Progress*, AM. BANKER, Sept. 8, 2008, at 1.

113. Anschutz, *supra* note 105.
114. Twomey, *supra* note 79.
115. HERA § 1402, National Housing Act § 257(c)(3).
116. Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15:3 HOUSING POL'Y DEBATE 753, 758 (2004).
117. Ineffective servicing has an immediate and substantial effect on investor profit. Investment income suffers if servicers fail to send monthly statements, accept and apply payments, calculate late fees, and address delinquent loans.
118. *Mortgage Liquidity du Jour: Underestimated No More*, CREDIT SUISSE, Mar. 13, 2007, at 28.
119. CONG. BUDGET OFFICE, *supra* note 25, at 9.
120. Some markets with high numbers of foreclosures may suffer from an overcorrection of housing prices.
121. 24 C.F.R. § 4001.120(c)(2).
122. 24 C.F.R. § 4001.120.
123. CONG. BUDGET OFFICE, *supra* note 25, at 9.
124. Sheila C. Bair, Chairman, FDIC, Statement Before the Committee on Financial Services, U.S. House of Representatives: Federal Deposit Insurance Corporation on Using FHA for Stabilization and Homeownership Retention (Apr. 9, 2008), available at [www.fdic.gov/news/news/speeches/chairman/spapr0908.html](http://www.fdic.gov/news/news/speeches/chairman/spapr0908.html). According to *American Banker*, FHA Commissioner Brian Montgomery was going to argue against an earlier version of the HOPE program because the program would permit "lenders or servicers to sell bad loans to the taxpayers." Stacy Kaper, *HUD Set to Argue Against Proposal to Expand FHA*, AM. BANKER, Apr. 9, 2008, at 1.
125. Although the HOPE program prohibits any person with an interest in a transaction involving a mortgage insured under the HOPE program from improperly influencing or attempting to influence the development, reporting, result, or review of a real estate appraisal sought in connection with the mortgage, lenders participating in the program will obviously be interested in establishing a higher market value for the property than the homeowner will. HERA § 1402, National Housing Act § 257(g).
126. HERA § 1402, National Housing Act § 257(h).
127. HERA § 1402, National Housing Act § 257(h)(3).
128. 24 C.F.R. § 4001.116(e).
129. Molly Sheehan, CQ CONG. TESTIMONY, Sept. 17, 2008. The FDIC is acting as the conservator for the former IndyMac Bank and is offering loan modifications to many IndyMac borrowers when those modifications are consistent with its duties under its pooling and servicing agreements. FDIC Chairman Sheila Bair indicated in testimony that IndyMac borrowers would be referred to the HOPE program if their income did not qualify them for other proposed modifications. Sheila Bair, CQ CONG. TESTIMONY, Sept. 17, 2008.



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