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INSIDE:

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Servicers Key to Limiting Loan Losses

By Harriet Newburger, Community Development Research Advisor

With the recent increase in delinquent loans, servicers are stepping up their loss mitigation activities, particularly in the subprime sector, where foreclosure activity is most pronounced and is expected to increase further as adjustable-rate mortgages (ARMs) reset. They are expanding outreach activities to homeowners at risk of or already in default, hoping to "work out" problems before they reach foreclosure stage. Some servicers are reorganizing or expanding their loss mitigation sections and some subprime servicers are adjusting the mix of loss mitigation tools they use in response to the current mortgage crisis.

Outreach activities. In more than half of the cases where mortgages are foreclosed, borrowers have had no contact with their loan servicers; in many cases, these borrowers have not responded to attempts by the servicer to reach them.[1] Borrower contact, either directly or through an intermediary such as a housing counseling agency, is the necessary first step in loss mitigation and servicers have undertaken a variety of outreach initiatives in an effort to improve their contact rates, several of which are described here.

A number of servicers, including Citi, JPMorgan Chase, Litton Loan Servicing, and Wells Fargo Home Mortgage, are contacting borrowers with ARMs multiple times, beginning as early as six months before the interest rates are scheduled to reset, with the goal of identifying and working to resolve potential problems before they occur. While such efforts tend to be national in scope, other forms of outreach are geographically targeted. Some servicers place outreach staff in communities where the default level is high or expected to become so. For example, through its Keychain Alliance (formerly called HOPE), GMAC-ResCap has outreach staff in 12 metropolitan areas, including Philadelphia, who not only work with other organizations involved in foreclosure

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A glossary of terms used in this article appears on page 13.

[1] Freddie Mac, Foreclosure Avoidance Research at www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf.

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Message from the Community Affairs Officer

The recent news about the increasing number of delinquent loans to subprime borrowers is distressing on many levels. We are all asking: How could so many otherwise intelligent investors misunderstand the risk? How could the lenders not understand the risk to their companies when the investors started requiring them to buy back loans that defaulted early? How many of the borrowers were too anxious to buy now rather than later, or buy more than they could afford? How many of the borrowers just kept thinking the next refinance loan was going to get them ahead of the game, instead of further behind? What will happen to the neighborhoods where many of these loans are going to foreclosure?

Out of all this distressing news comes only one good thing – the problem is so big that everyone has the motivation to work together. Servicers have a strong desire to keep a loan current because they must pay the investors the monthly principal and interest payments plus taxes and insurance if the borrower does not. At a recent meeting including servicers and nonprofit housing counselors in New York, one servicer reported that the average loss on a mortgage loan that goes to foreclosure is $62,000. Because of the overwhelming number of defaults, or "foreseeable defaults," the investors are reducing the legal constraints on servicers' ability to modify loans and the servicers are working with housing and credit counseling agencies to modify loans to a point affordable to the borrower. In this issue of *Cascade* we write about servicers' and counselors' efforts to minimize the loss and prevent foreclosure. It is hard work, but the results are important.

As you read these articles, there is one recurring theme – borrowers need to seek help early; ignoring the problem will not make it go away. We all need to help borrowers understand that even if they cannot stay in the house, working with the lender to sell the property or provide a deed-in-lieu, leaves both the lender and the borrower in a better position. Losing your home is a humbling experience.

As for the lenders and investors, I end only with a bit of advice, obviously too late for some, from a former boss, "Making a loan is easy; making one that gets paid back is the hard part."

Dede Myers

Publications and other resources related to the subprime mortgage market and foreclosure prevention are available at www.philadelphiafed.org/consumers/mortgages.

There are also three new publications: a technical brief on the new markets tax credit program; a Trenton, N.J., MSA community profile (the first in a series of updated profiles); and a summary of a Philadelphia Fed conference on recent developments in credit scoring. They are available under community development publications.

Servicer-Funded Counseling: A Resource for Homeowners

By Keith L. Rolland, Community Development Advisor

Nonprofit credit and housing counseling, once a quiet niche area, is suddenly in the limelight as a valuable way to help homeowners who are delinquent on their mortgage payments.

One of the main sources of such counseling is a national hotline operated by the Homeownership Preservation Foundation (HPF) in Minneapolis, Minn., and funded largely by mortgage-servicing companies and lenders. Calls to the hotline (888-995-HOPE) are automatically routed to one of five agencies that have contracts with HPF to provide counseling.[1]

The five agencies employ 112 counselors who are fully dedicated to answering hotline calls, a substantial increase from January 1, 2007, when 65 counselors were employed for this purpose. The counselors have counseling certification from the Association for Financial Counseling and Planning Education or the National Foundation for Credit Counseling and have expertise in delinquency and default counseling, a relatively new area in a field known for prepurchase counseling. The five are HUD-approved agencies.

Tracy Morgan, vice president for communications and business development at HPF, said: "The counselors' focus is on the entire financial picture, not simply the mortgage. Our counselors want to find out what led to this situation and whether it's temporary or permanent. They make recommendations on a homeowner's budget, explore ways to increase income or decrease expenses, and then provide an action plan and budget to guide the homeowner's next steps."

The counselors are available for follow-up counseling as needed. Counselors often facilitate a three-way conversation with the borrower and servicer and may also refer homeowners to local agencies as appropriate. Morgan said that the duration of HPF-funded counseling depends on each situation and may range from one hour to nine months. A caller to the hotline will find a counselor available 24 hours a day, seven days a week, Morgan said.

HPF reports that 15,205 homeowners were counseled in the second quarter of 2007, more than double the number counseled in the first quarter of the year.

Homeowners appear to be calling the hotline earlier. Of homeowners who called the hotline in the second quarter, 21 percent were less than one month behind in mortgage payments, compared to 14 percent in the first quarter. Fifty percent of callers were more than two months behind on mortgage payments, compared to 62 percent of callers in the first quarter.

HPF statistics for the second quarter of 2007 also show:

- Problems with fixed-rate mortgages were as likely as concerns with adjustable-rate mortgages;
- The states with the highest number of homeowners receiving counseling were Ohio, California, and Georgia;
- Forty-seven percent of callers reported annual household incomes of less than $36,000, while 11 percent of callers' annual household incomes exceeded $72,000.

Of incoming calls, 26 percent were referred by lenders and servicers, 19

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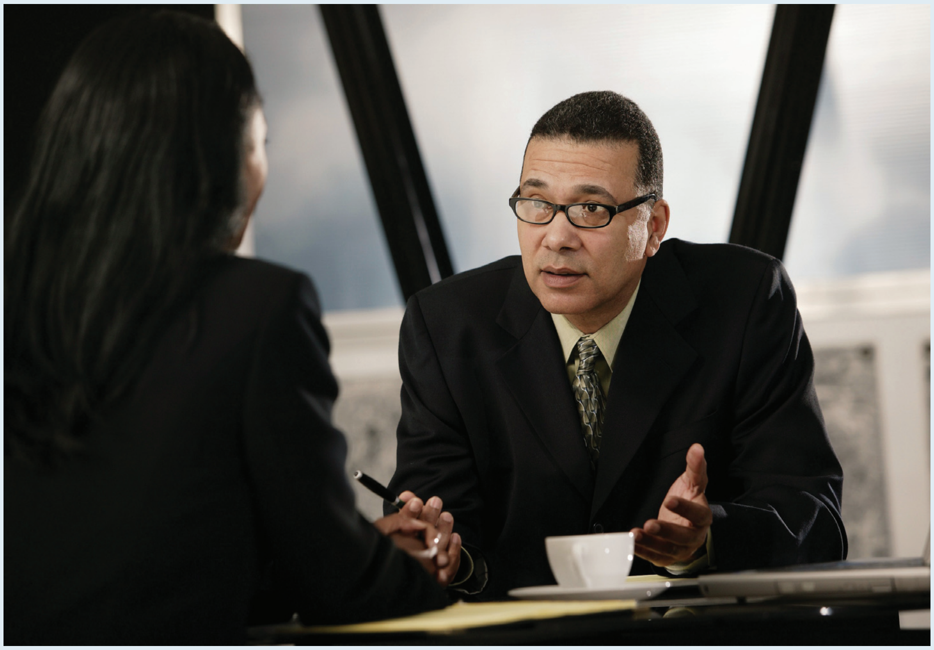

[1] The five are Auriton Solutions, based in Roseville, Minn.; Consumer Credit Counseling Service of Greater Atlanta; Consumer Credit Counseling Service of San Francisco; Novadebt, in Freehold, N.J.; and Springboard Nonprofit Consumer Credit Management, based in Riverside, Calif.

Nonprofits Help Freddie Mac and Servicers Reach Borrowers

By Keith L. Rolland, Community Development Advisor

Two large credit and housing counseling agencies have succeeded in reaching and working with some homeowners that servicers had been unable to reach.

Freddie Mac and seven residential mortgage loan servicers are working with the Consumer Credit Counseling Service of Greater Atlanta and the Consumer Credit Counseling Service of San Francisco to reach borrowers who were delinquent on their mortgage payments. The Atlanta nonprofit has 35 counselors who primarily provide delinquency and default counseling, while the San Francisco nonprofit has 17 counselors who primarily offer such counseling. Both nonprofits provide the counseling on a fee-for-service basis in the Freddie Mac partnership and in contracts with other servicers.

Freddie Mac drafted and mailed a letter and brochure to borrowers who were identified by the servicers. The letter explained that the nonprofits could provide financial and housing counseling and that options might include forbearance, a repayment plan, loan modification, or sale of the home.*

Bill Merrill, managing director of Freddie Mac's nonperforming loan servicing unit, explained that Freddie Mac sent the letters and brochures to about 41,000 borrowers starting in the spring of 2005. The counselors initiated phone calls to borrowers around the country and succeeded in reaching about 10,000 of them – about 25 percent – while about 4 percent of the borrowers responded to the letters on their own, he said.

About 5,500 of the 10,000 borrowers had the delinquency "cured," meaning that the loan was reinstated, paid off, or sent for a workout, as of the end of June 2007, Merrill said. The other 4,500 borrowers remained somewhere within the delinquency-to-REO (i.e., lender ownership) process. "Outbound phone contact is the most efficient method of communication and has produced the best results to increase contact rates," he said.

Freddie Mac officials said the company paid the two nonprofits an annual administration fee and payments per counseling session and per "cure" but declined to disclose the amounts.

It also provided counselors at these and other nonprofits with one-day training events covering forbearance, repayment plans, loan modification options, and Freddie Mac procedures. Merrill said, "Delinquency counseling is a relatively new area and we wanted our free training program to help train new counselors to continue to build industry resources to help borrowers."

Freddie Mac provides simultaneous training events for nonprofit counselors and servicers at regional campuses. Since April 2006, it has held 12 classes attended by 231 counselors, officials said.

Merrill said that "our biggest obstacles" in the outreach effort are overcoming borrowers' reluctance to discuss their delinquency and their fear of a foreclosure rescue scam.

Ingrid Beckles, vice president of servicing and asset management at Freddie Mac, commented that amid rising delinquencies and foreclosures, "one of the important glimmers of hope is the value of intervention from a trusted third-party intermediary.

"We find 30-day delinquencies often cure themselves as homeowners become current after falling behind. Forty-five to 60 days is our sweet spot when we try to refer homeowners for counseling. After 90 days, it's often too late. Legal fees that must be paid are triggered when foreclosure starts and arrearages become difficult to pay off."

Beckles said that Freddie Mac rewards servicers that provide foreclosure alternatives. Freddie Mac increased its incentive to servicers

About 5,500 of the 10,000 borrowers had the delinquency "cured," meaning that the loan was reinstated, paid off, or sent for a workout, as of the end of June 2007.

* Freddie Mac, a publicly traded company chartered by Congress in 1970, has a stated mission of providing liquidity, stability, and affordability in the U.S. housing market by purchasing residential mortgages and mortgage-related securities in the secondary mortgage market.

for completed repayment plans from $200 to $250 if a delinquent loan is reinstated or paid off through a repayment plan when the plan starts after 60 days of delinquency. Freddie Mac has a 100-point performance profile for servicers. The workout-to-REO ratio represents 35 points in the profile.

Beckles added that Freddie Mac has shortened the period during which it gives servicers incentives for avoiding foreclosure to encourage earlier intervention with delinquent borrowers. The period was 120 days before 2004 and was reduced to 90 days in 2005 and 60 days in 2006, she said.

CCCS of Greater Atlanta

Michelle Jones, vice president of counseling at the Atlanta CCCS, said that "servicers started coming to us in 2004 looking for solutions in foreclosure prevention." While servicers weren't as interested in working with nonprofits five years ago, she said "now they're really reaching out and want to help find solutions. They're very interested in working with housing counseling agencies because they believe we can be helpful."

Michelle Jones, CCCS of Greater Atlanta

The Atlanta CCCS saw the beginning of "a tremendous demand for services" and had the infrastructure to increase the number of delinquency and default counselors from four in 2004 to 35 currently, she said. Atlanta CCCS counselors are available to receive calls 24 hours a day, including weekends and holidays.

The counselors have names and phone numbers of key servicer contacts and a close working relationship with the servicers, Jones said. The counselors will also help develop loan workout packages as needed.

The vast majority of Atlanta CCCS delinquency and default counselors previously worked in the housing industry, for example, in servicing or loan origination. The counselors have a college degree, good credit, and must pass within their first six months of employment the six tests required by the National Foundation for Credit Counseling (NFCC) for credit counselor certification as well as an NFCC housing counseling test.

Jones shared these observations:

- Many homeowners prefer to be counseled by telephone. A small but increasing amount of housing counseling is online and the Atlanta CCCS also provides in-person counseling.
- Clients are more likely to take advantage of counseling services if a counseling session is available when the client makes that first phone call to the counseling agency.
- Counselors are more likely to achieve positive results if a mortgage delinquency is less than 90 days.
- Sometimes the solution isn't to stay in the house. If that's the case, the counselor works with the homeowners to identify the best exit strategy, allowing them to make a planned exit and minimize damage to their credit reports.

CCCS of San Francisco

Rick Harper, vice president and director of housing at the San Francisco CCCS, said the nonprofit's counselors call homeowners three or more times at different hours on different days. Many speak Spanish and other languages.

Harper said: "Nonprofits that want to establish delinquency and default counseling must make a real commitment in time and resources. They need a singular focus. They might want to design a business plan in conjunction with local credit unions and community banks that need this service."

Harper said that he has seen "a warmer, friendlier attitude by the [servicing] industry." He said that San Francisco CCCS counselors sometimes develop loss mitigation packages and added: "We see ourselves as an extension of the loss mitigation department, with our expertise being budgeting.

"Our counseling saves the lenders money. And it keeps people in their homes. It's a nice combination."

For information, contact Bill Merrill at william_ merrill@freddiemac.com; www.freddiemac.com; Michelle Jones at michelle.jones@cccsinc.org; www.cccsinc.org; and Rick Harper at rharper@housingeducation.org; www.housingeducation.org.

SPOTLIGHT ON RESEARCH

What Happens to Subprime Defaults?

Marvin M. Smith, Ph.D., Community Development Research Advisor

Concern about foreclosures has been heightened recently by the increase in subprime loans and the rise in the number of foreclosures. While there are numerous studies of foreclosure, one area that needs more consideration is the process that occurs after a borrower defaults and before a loan is eventually either restored to good standing ("cured") or ends in foreclosure. In a recent study, Dennis Capozza and Thomas Thomson examine this process for a sample of subprime mortgages and identify the important predictors of a loan's transition from default to its final state of being cured or foreclosed. What follows is a summary of their findings.[1]

Motivation for the Study

Lenders are well aware that some mortgage loans might default. Thus, they must exercise due diligence when deciding which mortgage applications to approve. Several studies have aided lenders in their decision-making process by highlighting the determinants of default. However, these studies generally define default as "the completion of the foreclosure process and sale of the collateral." While these studies are helpful, they fail to shed light on the period of transition, which can be quite complicated and involve many steps, before the loan results in foreclosure or is cured. An understanding of the process from a loan's delinquent status to cure or foreclosure can be especially instructive given the rise in subprime lending and the mounting evidence that the behavior of subprime borrowers differs from that of prime borrowers. Capozza and Thomson cite research that indicates "subprime mortgage loans default earlier than prime loans and the losses are larger than for prime loans."

Since subprime borrowers tend by definition to have less than perfect credit, lenders charge a higher interest rate to compensate for the greater risk associated with the loan. Because of the interest rate premium,[2] a payment from a subprime borrower contributes more to net revenue than one made by a prime borrower. Therefore, the prospect of potential net revenue from an active loan account might affect a lender's or investor's treatment of a borrower with delinquent payments. In fact, the authors point out that "given the high delinquency rates reported for subprime mortgage pools, relative to the number of foreclosures, forbearance and extension rather than immediate foreclosure are common reactions to missed payments."

The authors consider two explanations. First, they "hypothesize that loans will transition less quickly to foreclosure and REO[3] when one more payment is more valuable to the lender because the interest rate premium is higher." Second, they "conjecture that foreclosure will be delayed when measures of borrower creditworthiness, such as bureau scores, payment to income ratios, time on the job, etc. are weaker." The authors test these hypotheses using a unique sample of subprime mortgages.

Data and Methodology

Capozza and Thomson tracked a sample of 6,181 mortgage loans origi-

[1] Dennis R. Capozza and Thomas A. Thomson, "Subprime Transitions: Lingering or Malingering in Default?" *Journal of Real Estate Finance and Economics*, vol. 33, no. 3 (November 2006), pp. 241-58.

[2] This denotes the spread between the interest rate of a subprime mortgage and the rate for prime mortgages originated during the same month.

[3] REO stands for "real-estate owned" and represents real estate acquired by a lender via foreclosure and held in its inventory until sold.

nated by a national subprime lender. The loans were in default (90 days or more delinquent) on September 30, 2001. The data used in the analysis contained information on the loan, the borrower, and the type of property.[4] The authors studied the transition of the loans to their status eight months later. The possible outcomes at the later date were: (1) the loan remains delinquent without further deterioration, (2) the loan is in foreclosure or becomes REO, (3) the loan becomes more delinquent, i.e., worsens, (4) the borrower is in bankruptcy, or (5) the loan is cured.

First, the authors focused on the overall transition outcomes and then modeled the transition of the loans to one of the states above using regression analysis.[5]

Findings
The authors divided the sample of defaulted loans into two groups according to whether, on September 30, 2001, borrowers were not in bankruptcy (4,243 loans) or were in bankruptcy (1,938 loans) and noted the status of the loans eight months later. They found that 59 percent of the 4,243 defaulted loans were still in default status; 24 percent became REO; for 11 percent the borrower entered bankruptcy; and 6 percent were cured. After the eight-month period for those loans with a borrower initially in bankruptcy, 69 percent remained with a borrower in bankruptcy, 18 percent were in default but the borrower was not in bankruptcy, 12 percent went to REO, and 2 percent were cured. This, the authors suggest, indicates that defaulted loans with the borrowers not in bankruptcy and those in default and the borrowers originally in bankruptcy tend to remain in their respective status for an extended period.

The authors regarded the percentages as constant transition rates and used them to project the rate at which loans either reach REO or are cured. Using these transition rates, there would be a total of 2,159 loans in REO after the second round.[6] After numerous rounds, they found that 79 percent of the sample loans would reach REO, while 21 percent would ultimately be cured; it would take "about six and one half years for 90% of the transitions to the final states to occur and confirms that subprime loans linger in a delinquent state for extended periods of time." The authors also noted that the transition results of their loan sample to REO differed from those reported in the literature for conventional or FHA loans. Their subprime sample was "about twice as likely to transition to REO but [took] about four times longer to get there."

For a more in-depth investigation of the transition process, Capozza and Thomson used regression analysis to examine the determinants of a loan's transition from default to one of the other possible states mentioned above. Concentrating on the loans initially in default but the borrowers not in bankruptcy, they found the following:

- Loans with a high interest rate premium were more likely to remain in default and less likely to enter foreclosure (REO).
- Loans with longer delinquency periods (90 days or more) were more likely to transition to REO and more likely to worsen (more months' delinquent) and less likely to transition to cured.
- An increase in the number of payments made tended to lower the probability of transition to other states (including cured).
- Lenders were more likely to foreclose on loans with high loan-to-value ratios.
- Lenders were less likely to foreclose on defaulted loans during periods of economic growth or declining interest rates.

The analysis of the loans originally in default and the borrowers in bankruptcy revealed:

- Increases in the interest rate premium tended to lower the probability that a loan (of a borrower in bankruptcy) would worsen.
- A higher payment-to-income ratio increased the likelihood a loan would transition to REO, while more time on the job decreased the likelihood.
- More loan payments decreased the likelihood of transition to REO, default, or worsening.

In general, the authors observed that the "most economically important predictors of transition from default to any other state are the number of payments the borrower has made and the loan-to-value ratio."

[4] In particular, the data included the loan purpose, type of interest rate, level of documentation required, loan-to-value ratio, interest rate premium, prepayment penalty, credit score, payment-to-income ratio, time on the job, time at the property, single family and/or owner-occupied home, months' delinquent on loan, and number of payments made on loan.

[5] The movement of the loans during the eight-month period reflected the interaction of the choices made by the borrower and the lender. The borrower decides whether to make payments on time, stop payments, pay the amount in arrears, or declare bankruptcy, while the lender decides if and when to conduct foreclosure proceedings.

[6] The number of loans cured after the second round can also be calculated.

ACORN Seeks Affordability in Loan Modifications

By Keith L. Rolland, Community Development Advisor

ACORN Housing Corporation (AHC), which negotiated with banks to broaden eligibility criteria for first-time homeowner loans, is advocating borrower affordability standards in its discussions with servicers on loan modifications. ACORN organizers have also visited homes and established contact with at least 515 homeowners whom servicers had been unable to reach.

Bruce Dorpalen, national director of AHC, a 501(c)(3) founded in 1985 by the Association of Community Organizations for Reform Now (ACORN), said AHC counselors focus on the affordability needs of homeowners it counsels. "We believe that solutions for the homeowners we counsel must be based on what owners' can afford long-term rather than repayment agreements, which are widely used but are often unaffordable."

AHC counselors examine a homeowner's income and expenses, look for areas to reduce expenses, allow for a $500 monthly surplus and an additional $200 per dependent, and seek a maximum debt-to-income ratio of 50 percent, Dorpalen said. The counselors identify the monthly payments that an owner can afford, typically with a reduction of interest rate, extension of term, and in some cases principal reduction, and make a proposal to the servicer.

AHC has established a network of 35 servicers that enables AHC's housing counselors to work with senior servicing managers to negotiate resolutions for clients, Dorpalen said. He added: "The network ends the problems many counselors had with unreturned calls, servicers refusing to work with counseling agencies, and servicer representatives not willing or able to modify loans.

"More servicers are buying into foreclosure prevention to better figure out affordable solutions because foreclosures have a high cost to them. The mortgage servicer and the investor are usually better off with an affordable loan modification and a paying borrower than an expensive foreclosure and need to resell the property."

From October 2006 to early June 2007, AHC worked with 1,162 servicer customers, of whom 39 percent were still in counseling at the end of the period, while 30 percent received loan modifications and 8 percent brought their loan current or refinanced it, Dorpalen said. AHC is receiving about 350 calls monthly from homeowners, he added.

> "The mortgage servicer and the investor are usually better off with an affordable loan modification and a paying borrower than an expensive foreclosure and need to resell the property."

HSBC – North America

The servicer with which AHC has worked most closely is HSBC – North America. Dorpalen said that HSBC and AHC use a formula based on household income and expenses to determine the affordability of the mortgage payment. If the house payment is not within the affordability range, the interest rate is lowered by five points to bring it into affordability, he said, adding that HSBC pro-actively communicates about the program in mailings to borrowers who are 60 days or more late.

Dorpalen said that in the HSBC effort AHC counselors worked with 2,864 clients from October 2003 through January 2007. Of proposals submitted by AHC, HSBC approved 85 percent of the clients, he said, adding that "this process has been quicker than traditional loss mitigation."

An HSBC spokesperson said: "HSBC offers a foreclosure avoidance program as one of many options available to our customers who are facing a financial hardship. We are pleased that as a result of our successful collaboration with ACORN, our customers not only receive the immediate payment relief that HSBC provides but also benefit from the personalized one-on-one financial counseling provided by ACORN's housing counseling specialists."

Countrywide

In addition, AHC has worked with Countrywide to re-engage no-contact borrowers. ACORN organizers visited 1,514 homes in Texas, Ohio, Michigan, Louisiana, and Michigan from June 2006 to February 2007. The organizers established contact with 515 owners, 304 of whom called AHC for assistance. Others contacted Countrywide directly.

Countrywide had these comments on its experience with ACORN: "ACORN has been invaluable to us in our efforts to assist homeowners in distress. The formal relationship between ACORN and Countrywide started as an outgrowth of Hurricanes Katrina and Rita disaster recovery efforts. Countrywide needed assistance in locating borrowers who lived in the most heavily affected areas in Louisiana and Texas. ACORN's results were so positive that we expanded our relationship to the other states previously mentioned, and will further expand the outreach effort this year to other states."

Although home visits worked well in the Countrywide effort, Dorpalen said that telephone counseling is generally "more effective in delivering counseling services to homeowners in crisis and is more efficient." AHC provides telephone counseling through an AHC call center in Chicago that has a six-member staff available five days a week from 10 a.m. to 7 p.m.

In addition, AHC has 112 counselors who do face-to-face counseling in 39 offices, including one in Philadelphia and another in Newark, N.J.

Increasingly, AHC works with owners and their servicers before owners become delinquent, Dorpalen said. The owners may have an adjustable rate reset within six months, or they may be making regular payments by not paying other bills or financing them on credit cards, but the payments are clearly unsustainable. AHC is asking servicers to modify these loans without requiring homeowners to first become delinquent on their payments.

Dorpalen said: "We see many people who never should have been in 2/28 and other adjustable mortgages. They have sufficient income and credit to qualify for a 30-year fixed-rate loan. They often didn't know they had adjustable-rate mortgages.

"Some of these mortgages were sold to borrowers by mortgage brokers as the only product they could qualify for," he said, adding that brokers and others wanted to sell subprime products in large volume. Dorpalen added that "there was a lot of churning of subprime mortgages for one or two years, at the end of which the owner would incur substantial refinance costs."

Ameriquest

In 2000, AHC signed an agreement with Ameriquest Mortgage Company* in which Ameriquest agreed to follow best practices and AHC agreed to provide low-income residents with financial education and counseling.

Adam Bass, senior executive vice president and vice chairman of Ameriquest, said: "Our agreement with ACORN established industry-leading standards, which we continued to build upon." According to the company, the origination best practices established in the 2000 agreement with AHC were updated in 2003 and a set of servicing best practices were added.

AHC's original agreement with Ameriquest also included a pilot lending program that made financing available to residents in 10 low- and moderate-income neighborhoods. Asked for comment about the pilot program, Dorpalen said "It was excellent on paper. The company offered the best subprime product in the market. It was difficult to implement because it was so outside the company's business systems and culture."

Bruce Dorpalen,
ACORN Housing Corporation

Only a few of the 35 servicers pay AHC for its work with delinquent borrowers. Dorpalen said that homeowner counseling must be reimbursed in order to build a long-term infrastructure for this service.

AHC counselors receive one week of internal training with a senior counselor and periodic workshops, Dorpalen said. The counselors are not certified by the National Foundation for Credit Counseling, he said.

AHC has purchased foreclosure lists and contacted borrowers in Detroit and Denver but has not done the same in Philadelphia because funding has been unavailable, he said.

Speaking about subprime lending, Dorpalen said: "There's no reason that you can't have a clean subprime loan without high fees and adjustable rates, balloon payments, and pre-payment penalties, as long as it has a fixed rate."

For information, contact Bruce Dorpalen at bdorpalen@acornhousing.org; www.acornhousing.org; www.us.hsbc.com; www.countrywide.com; and www.ameriquestmortgage.com.

* ACC Capital Holdings (ACH) is maintaining operations as it prepares for the orderly wind-down of Ameriquest Mortgage Company, ACH's retail mortgage business. Ameriquest stopped accepting applications in August 2007. On Sept. 1, 2007, ACH completed the sale to Citi of ACH's wholesale mortgage origination and mortgage servicing assets. The acquisition includes the purchase of servicing rights on $45 billion of loans.

State HFAs Debate Refinance Programs

In new efforts to help homeowners at risk of losing their homes, some state housing finance agencies (HFAs) are developing refinance programs, while many others are wrestling with whether and how they might do so.

HFAs in Ohio, Colorado, Massachusetts, New York, Pennsylvania, and Maryland have launched refinance programs. New Jersey, Wisconsin, Minnesota, and other state HFAs are planning such programs.

Garth Rieman, director for housing advocacy and state initiatives at the National Council of State Housing Finance Agencies, said that the HFAs "are looking at owner needs and program benefits, but they don't want to be perceived as bailing out lenders and investors for making unscrupulous loans or owners who should have understood the consequences of their loans. They are trying to help owners who accepted unsuitable loans unknowingly. They are also trying to avoid perpetuating harmful negative lending patterns by getting borrowers into the more suitable first-time products they offer."

HFAs have generally offered subsidized-rate loans for first-time owners but lack experience with refinance products and have limited resources to start refinance programs, he added.

Ohio, which has one of the country's highest foreclosure rates, is the first state that has implemented a refinance program, Rieman said. The Ohio Housing Finance Agency (OHFA) provides a 30-year fixed-rate conventional loan to borrowers who are up-to-date with payments on their current loan. The refinance loan is a Fannie Mae My Community Mortgage product with a Fannie Mae guarantee to investors who purchase the loans.

Ohio's refinance program, which is restricted to borrowers with incomes at or below 125 percent of county median gross income, requires full documentation, a full appraisal, private mortgage insurance if the loan is above 80 percent loan-to-value, and at least four hours of homeowner counseling. In addition, OHFA offers a 20-year fixed-rate second mortgage for up to 4 percent of appraised value for closing costs, escrow accounts, and attorney or late fees.

Joel Ghitman, OHFA's director of homeownership, said that between April and the end of July 2007, lenders closed 15 loans totaling $1.9 million with another 101 loans in the pipeline. About 150 of the 185 lenders that normally participate with OHFA are originating the refinance loans, he said. The interest rate on both the first and second mortgages in the program was 6.75 percent initially and 7.50 percent at the end of July 2007.

Ghitman said, "Our intent is to get borrowers who are in an adjustable mortgage, such as a 2/28, into a fixed-rate product before they become delinquent on their payments. It's not designed to be a foreclosure prevention and rescue product." He said that the refinance applications coming into OHFA were prime, subprime, and Alt-A loans. He added that the agency had never previously made refinance loans and is still fine-tuning the product, which is initially funded through the issuance of taxable bonds.

Ghitman said that OHFA cannot be the sole solution for Ohio's foreclosure crisis and explained that the program has two major drawbacks. First, servicers have been uncooperative and unwilling to write off the difference between the original appraisal and the current appraisal, which is lower because of falling home prices or because the original appraisal was inflated, he said. Second, many applicants are 60 to 120 days' delinquent and late payments become one of multiple risk factors that make them ineligible under Fannie Mae's Desktop Underwriter auto-

Delaware Starts Mortgage Assistance Program

A program started earlier this year by the Delaware State Housing Authority provides homeowners who are 60 days or more delinquent in mortgage payments with assistance for up to 12 months. It is intended to help owners who have fallen behind on mortgage payments owing to circumstances beyond their control, such as temporary loss of employment, illness, or divorce.

As of the end of July 2007, 11 loans totaling about $130,000 have been approved while 26 others are in process.

The program was modeled after Pennsylvania's Homeowner's Emergency Mortgage Assistance Program.

For information, contact Anas Ben Addi at anas@destatehousing.com; www.destatehousing.com.

mated system, he added.

"Until we can get a better profile of the borrower, and demonstrate that these loans perform well, lenders and Fannie Mae are going to be very conservative in their underwriting guidelines," Ghitman said.

Ghitman said that there is often a disconnect between lenders' collection departments and loss mitigation departments. He explained: "Once it goes over 30 days, a loan is referred to the collections department. After 60 days, it goes to a loss mitigation department, which has the ability to do a workout. Homeowners who have been pursued by the lender's collections staff find it hard to believe that the loss mitigation staff really wants to work with them. Some of the loans should be moved to the loss mitigation department sooner because the department has the authority to do a workout.

"Housing counseling nonprofits can play a huge role in bridging the servicer and borrower."

Ghitman observed that automated underwriting works well for purchase loans but not as well for refinance loans. He thought manual underwriting was needed.

He said that OHFA and its lenders decided to use Fannie Mae's My Community Mortgage for the refinance program because they had used the product for OHFA's first-time homeowner program. He said the refinance program allows use of Fannie Mae's Expanded Approval process under the My Community Mortgage program.

Ghitman said: "I would really like to have the ability to give a new loan with a comparable payment to borrowers whose financial difficulty lies solely in the rate reset." He concluded: "The earlier we can get in touch with borrowers, the more options can be made available to them. Early intervention is critical to keeping these owners in their homes."

Meanwhile, Maryland is offering a Lifeline refinance mortgage through participating lenders. The program has limits pertaining to maximum household income, current appraised value, and loan to value ratio. Counseling is required for applicants who have credit scores below 680.

For information, contact Garth Rieman of NCSHA at grieman@ncsha.org or David Heimann of OHFA at dheimann@ohiohome.org;www.ohiohome.org.

— Keith Rolland

More Consistency Sought in Broker Licensing

A residential mortgage licensing system to manage state licensing of mortgage brokers, lenders, and bankers is being developed by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR).

Most mortgage lending is licensed and regulated at the state level. A CSBS survey last year estimated that states manage approximately 90,000 mortgage company licenses, 63,000 branch licenses, and over 280,000 loan officer licenses.

"There has been a lack of uniformity among state laws and regulations and clearly we have the need to modernize," said Bill Matthews, senior vice president of CSBS. The system is being developed to streamline the licensing process for regulators and the mortgage industry, provide accountability of industry professionals, and reduce fraud.

Thirty-five states to date have already indicated their intent to participate in the system and at least 15 states are to participate in its first stage, which is scheduled to start early next year, Matthews said.

Consumers will have access to public licensing and enforcement actions related to licensed mortgage lenders, brokers, and loan officers, according to plans of the CSBS and AARMR.

The plans envision that the states will bear the system's development costs and the mortgage industry will pay for operating costs. The Financial Industry Regulatory Authority (FINRA), which was created in July 2007 through the consolidation of the National Association of Securities Dealers and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange, has been contracted to develop and operate the system.

For information, contact Bill Matthews at bmatthews@csbs.org; www.csbs.org; www.aarmr.org; www.finra.org.

 ...continued from page 1

prevention but also meet one-on-one with borrowers to explore their options.[2] Another model is provided by EMC Mortgage Corporation, whose 50-member "Mod Squad," a team of loan modification experts, visits cities where loan delinquencies are rising to work face-to-face with delinquent borrowers.[3]

Expanding loss mitigation strategies in the subprime sector. The degree to which specific loss mitigation strategies have been used has differed for the prime and subprime sectors, even among servicers who work in both areas. In particular, loan modification has been much more commonly used for prime than for subprime loans. A majority of subprime loans are pooled, securitized as private-label securities, and sold to investors,[4] and the low use of loan modifications in this sector has reflected, in part, a belief among servicers that pooling and servicing agreements (PSAs) put strict limits on the conditions under which this loss mitigation tool may be used.

In light of specific factors contributing to the ongoing foreclosure crisis, the effectiveness of loan modification for loss mitigation is likely to grow relative to other tools more commonly used for subprime workouts, according to a recent analysis by Fitch Ratings.[5] For example, implicit in the use of forbearance and repayment plans is the assumption that homeowners, despite possible short-term economic setbacks, have the long-term ability to make their stipulated mortgage payments. However, it is anticipated that after interest rates reset on ARMs, many homeowners will lack the financial resources needed to cover the higher payment amounts on an ongoing basis. Some, though not all, of these owners may be able to maintain ownership with a loan modification.[6]

In response to the current situation, modification of subprime loans is becoming more common.

In response to the current situation, modification of subprime loans is becoming more common. Litton Loan Servicing, which has modified subprime loans in the past, is now using this option in a higher percentage of cases than previously. GMAC-ResCap, which had not previously used loan modification for subprime loans, recently established a team within its loss mitigation unit expressly for this purpose.

In addition, as a result of the current subprime situation, the degree to which PSAs allow for loan modification has received greater scrutiny. The American Securitization Forum issued guidelines on this issue in June 2007 in order to "facilitate wider and more effective use of loan modifications in appropriate circumstances."[7] The guidelines stress that most PSAs allow for loan modification when a loan is in default or when default is "reasonably foreseeable." They also address servicer concerns about the amount of a securitized subprime loan pool that may be modified. Joseph Ohayon of Wells Fargo Home Mortgage believes that because these guidelines provide consistent direction to servicers, they

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[2] Interviews were conducted with Heidi Coppola, director, mortgage finance, Natalie Abatemarco, vice president, and Robin Kramer, vice president, default administration, Citi; Donna Sheline, director, homeownership preservation office, JPMorgan Chase; Mark Folweiler, community relations specialist, Keychain Alliance, GMAC-ResCap; Stephen Staid, senior vice president, and Donna Marie Jendritza, public relations manager, Litton Loan Servicing, L.P.; and Joseph Ohayon, vice president, and Debora Blume, communications specialist, Wells Fargo Home Mortgage.

[3] Kenneth Harney, "Mortgage Mod Squad," *Washington Post*, April 14, 2007; F01.

[4] Public label mortgage-backed securities are issued by the government-sponsored enterprises Fannie Mae, Freddie Mac, and Ginnie Mae, while private-label mortgage securities are issued by banks and other private entities. For further information, see American Bar Association, GP/Solo Law Trends and News, Business Law, September 2005 at www.abanet.org. Also see remarks by Martin Gruebner, vice chairman, FDIC, to the Conference of State Bank Supervisors, May 2007 at www.knowledgeplex.org/news/532301.html.

[5] Fitch Ratings, *Changing Loss Mitigation Strategies for U.S. RMBS*, U.S. Residential Mortgage Special Report, June 4, 2007.

[6] In addition, the American Securitization Forum (ASF) notes that, unlike other loss mitigation tools, loan modification can be used prior to default if default is reasonably foreseeable. ASF's *Statement of Principles, Recommendations, and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans*, June 2007, is available at www.americansecuritization.com. (The ASF is an independent, adjunct forum of the Securities Industry and Financial Markets Association; its membership consists of more than 350 organizations that participate in the U.S. securitization market.)

[7] See footnote 6.

will further encourage the use of loan modification as a loss mitigation tool for subprime loans.

Servicers have also expanded their range of loss mitigation activities in other ways. Wells Fargo Home Mortgage has created new units within its loss mitigation department that specialize in second liens and short sales. JPMorgan Chase provides a cash for keys program in which consumers may receive financial assistance in the transition to a new dwelling when they cannot maintain ownership. In Citi's Ownership Loss Mitigation Program, a particular loss mitigation specialist is assigned to a subprime borrower who is in default, increasing consistency in the workout process for both the borrower and Citi itself. Citi has also developed stop-gap programs to slow foreclosure in states where it would otherwise proceed very rapidly, allowing more time for loss mitigation activities.

Loss mitigation does not guarantee that borrowers will retain their homes. A 2007 survey of servicers indicated that the percentage of loss mitigations that resulted in either short sales or deeds-in-lieu ranged from less than 10 percent to more than 35 percent.[8] However, even when loss mitigation leads to outcomes in which borrowers do not keep their properties, the costs to them and their communities are likely to be lower than had there been a foreclosure.

[8] See footnote 5.

Glossary of Terms*

Loan servicer – An entity that collects scheduled loan payments from a borrower, transfers principal and interest to investors, and has lead responsibility for finding a solution if the borrower is in arrears.

Loss mitigation – Servicers try alternatives to foreclosure to avoid or reduce losses that would be incurred if the loan went into foreclosure.

Loan modification – A permanent change in one or more of the original terms of the mortgage, such as lowering the interest rate or extending the repayment period, to make payments more affordable to the borrower.

Repayment plan – The borrower resumes regular monthly payments, plus some of the amount that is past due, until the loan is current.

Forbearance agreement – Provides for a temporary reduction or suspension of payments for a specified length of time.

Short sale – A property is sold for less than the outstanding loan amount and the lender accepts the proceeds, in satisfaction of the mortgage.

Deed-in-lieu of foreclosure – A borrower voluntarily deeds the property to the lender in exchange for cancellation of the mortgage debt.

* Glossary terms have been adapted from Freddie Mac, Fannie Mae, and HUD sources.

District News

The Federal Home Loan Bank of Pittsburgh has placed new emphasis in its Affordable Housing Program on projects that reflect broad stakeholder collaboration and community-wide planning. The deadline for AHP applications for the 2007-B funding round is September 27, 2007. For information, contact John Bendel at (800) 288-3400; www.fhlb-pgh.com.

The Housing Assistance Council, a national nonprofit that supports the development of rural low-income housing, has launched a Rural Housing Data Portal, a searchable database with access to social, economic, and housing data. Go to www.ruralhome.org/dataportal.

Infill Philadelphia, a five-year initiative of the Community Design Collaborative, promotes innovative design solutions for the reuse of obsolete or underutilized buildings and sites in older urban neighborhoods. See www.infillphiladelphia.org.

Going Comprehensive: Anatomy of an Initiative That Worked examines the Comprehensive Community Revitalization Program, a community building program in the South Bronx, and is available at www.lisc.org/content/publications/detail/5396.

Papers from the 2007 **Federal Reserve System Community Affairs Research Conference** are at www.chicagofed.org/cedric/papers_index.cfm. The conference focused on the factors governing the availability of credit and capital within a changing financial services environment.

Conduits to Consumers

At least a dozen servicers are providing single points of contact to nonprofit housing-counseling, legal-service, and housing-advocacy agencies, giving staff of the agencies expedited access to the servicers through dedicated toll-free phone numbers and e-mail addresses.

Donna Sheline, director of JPMorgan Chase's homeownership preservation office (HPO), said the nonprofits can play a critical role by educating consumers on the available options. Heidi Coppola, director of mortgage finance in Citi Markets and Banking (Citi's investment bank), observed that consumers view the nonprofits as "independent and trusted" and will sometimes talk to them when they won't talk to servicers.

Citi, GMAC-ResCap, JPMorgan Chase, Litton Loan Servicing, L.P., and Wells Fargo Home Mortgage indicated in interviews that they have:

- Held meetings with nonprofits in cities in which they have sizable mortgage-loan portfolios in order to explain loss-mitigation options and requirements;
- Held meetings for homeowners to provide education on the alternatives available to avoid foreclosure; and
- Joined task forces with nonprofits and government agencies at national, regional, or local levels.

JPMorgan Chase's HPO has held over 50 foreclosure-prevention training events attended by 1,800 nonprofit housing counselors, regulators, public officials, and others. JPMorgan Chase plans to conduct another 25 events this year.*

Litton Loan Servicing, L.P., met earlier this year with community organizations in Ohio and signed memorandums of understanding with the East Side Organizing Project in Cleveland and Working in Neighborhoods in Cincinnati. The agreements, which were requested by the community organizations, discuss the two parties' commitment to work together, plans for communications including face-to-face meetings and how housing counselors will work with Litton's servicing staff.

The response of homeowners to the educational meetings held by the five servicers has varied widely. In one instance a servicer cancelled an August 2007 meeting because of very low enrollment.

The five servicers have varying policies on reimbursing nonprofits for counseling and budgeting work. One servicer has not entered into agreements to reimburse nonprofits for housing counseling in a fee-for-service arrangement, although it does provide general operating grants to some of the nonprofits. Another pays nonprofits only when it asks them to provide counseling.

Servicers are engaged in a wide range of pilot programs with nonprofits and investors, including Fannie Mae and Freddie Mac. Wells Fargo Home Mortgage has a national pilot program with one of its investors aimed at identifying loss mitigation opportunities with Chapter 13 bankruptcy borrowers who have recently become delinquent on their post-petition payments, explained Joseph Ohayon, the company's vice president of community and client relations. Wells Fargo is working with bankruptcy attorneys to extend loan modifications to homeowners who meet the terms and conditions of the program, which will result in effectively curing the delinquency if agreed upon, he said.

Sheline commented: "In the last three years, the dialogue between servicers and nonprofit housing counselors and housing advocates has come a long way. Through open communication, education, and mutual respect, we are able to better understand the respective value each can provide on foreclosure prevention."

For information, contact Robin Kramer of Citi at robin.kramer@citi.com, Mark Folweiler of GMAC at mark.folweiler@homecomings.com, Donna Sheline of JPMorgan Chase at donna.j.sheline@chase.com, Donna Marie Jendritza of Litton Loan Servicing, L.P. at donnamarie.jendritza@litton.c-bass.com, and Joseph Ohayon of Wells Fargo Home Mortgage at joseph.ohayon@wellsfargo.com.

The five servicers have established the following single points of contact for housing counselors: Citi, 866-517-0820, Mortgagehelp@citigroup.com; GMAC, Mark Folweiler (contact person for Pennsylvania, New Jersey, and Delaware) at (215) 734-5359 or mark.folweiler@homecomings.com; JPMorgan Chase at (866) 345-4676 or hpo.chase@chase.com; Litton Loan Servicing, L.P. at (713) 218-4592 or executiveresolution@litton.c-bass.com; and Wells Fargo Home Mortgage at (866) 480-5004.

– Keith Rolland

* JPMorgan Chase's HPO has also provided training events for realtors on short sales.

Municipalities Struggle with Foreclosed Houses

Local governments in communities with a substantial number of vacant foreclosed properties are struggling to meet the demands and costs of maintaining the properties.

Municipalities are fixing broken windows, mowing lawns, and sometimes installing alarms to try to prevent blight from spreading to the rest of the community. Municipalities lose property taxes after properties become vacant and find that their expenses rise as a result of increased fire and police calls related to the properties.

Mark Wiseman, director of a foreclosure prevention program in Cuyahoga County, Ohio, which includes Cleveland, said that municipalities in the county "don't have vacant property departments" and existing building and other departments don't have the staff or the budget for a major property maintenance role.

The problem of increased vacancies "is catching Cuyahoga County communities flat-footed," he said. They are responding in a "piecemeal" fashion, he said, with different departments doing what they can.

"It's hard for a municipality to know who owns a foreclosed house due to multiple changes of ownership," Wiseman said. Municipalities could place a special assessment for such tasks as cutting the grass but few have filed suit against title companies to recover such costs, he said.

In July, the county asked eight inner-ring suburbs of Cleveland how much they were spending on maintaining vacant properties. The suburbs, which had about 3,500 vacant houses at the time, had difficulty coming up with cost figures but estimated they had spent roughly $1.5 million on vacant property-related costs so far this year, he said. At the time, Cleveland had at least 9,000 vacant houses with virtually no buyers moving into the city, he said. A vacant Cleveland house is often stripped of doors, cabinets, and copper piping in three days and then it costs more to rehabilitate the house than the house is worth, Wiseman said.

In 2006, the Cuyahoga County treasurer's office started a foreclosure prevention effort in which the county provides grants to nine housing nonprofits to add staff for counseling and provided staff with training on foreclosure workouts. The office has also marketed an area hotline that homeowners can call for assistance.

For information, contact Mark Wiseman at trmnw@cuyahogacounty.us; www.dontborrowtroublecc.org.

Servicer-Funded Counseling: A Resource for Homeowners

...continued from page 3

percent by professionals or friends, 19 percent by media coverage, and 7 percent by NeighborWorks affiliates.

A predecessor program of HPF started to provide foreclosure prevention counseling for GMAC Homecoming customers in 2002. HPF was launched with a $20 million grant in 2003 from GMAC RFC (now GMAC ResCap) following a pilot program in Chicago, that had positive results helping homeowners avoid foreclosure. Other major funders of HPF include Citicorp, Countrywide, Home Loan Services (a subsidiary of Merrill Lynch), HSBC, JPMorgan Chase and Company, Ocwen, Washington Mutual, Wilshire Credit Corporation, and Fannie Mae, Morgan said.

HPF pays the five agencies an undisclosed amount, including salary and administration costs, for each counseled homeowner, Morgan said.[2]

NeighborWorks – Ad Council Campaign

NeighborWorks America has worked with the Ad Council to develop a three-year media campaign to inform homeowners who are delinquent on their mortgages that assistance is available from the HPF hotline. The campaign, which is being unveiled around the country, is funded largely by servicers.

In addition, NeighborWorks has commissioned a study on the impact of counseling provided through the HPF hotline.

For information, contact Tracy Morgan at tmorgan@995hope.org; www.995hope.org. To learn about the Ad Council campaign, go to www.foreclosurehelpandhope.org. For information on NeighborWorks Center for Foreclosure Solutions, go to www.nw.org/network/home.asp.

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[2] HPF is also providing up to $1.2 million to assist the National Urban League in a foreclosure prevention and education program targeted to Houston, St. Louis, and Philadelphia.

Calendar of Events

Innovative Financial Tools for Serving the Underbanked
Financial institutions and nonprofits are making lower-cost products and services available to the underbanked market (people who primarily conduct their financial transactions outside mainstream financial institutions).
October 16, 2007, Federal Reserve Bank of Philadelphia.
For information, contact Christy Chung Hevener at (215) 574-6461 or christy.hevener@phil.frb.org; www.philadelphiafed.org/cca/conferences.html.

National Inclusionary Housing Conference: Building Strong Mixed-Income Communities
Presented by Business and Professional People for the Public Interest, the Innovative Housing Institute, the National Housing Conference, and PolicyLink.
October 30–November 1, 2007, San Francisco, Calif.
For information, go to www.inhousing.org/conf or call (703) 698-8151.

Homes Within Reach Conference
A training and networking event with 45 workshops, including innovative housing and homelessness programs and policy.
December 6–7, 2007, Harrisburg, Pa.
Details will be posted at housingalliancepa.org.

Opportunity Finance Network Conference
Annual conference includes innovative financing products and challenges facing community development financial institutions.
December 11–14, 2007, Miami, Fla.
For details, see www.opportunityfinance.net/conference.

Regional Equity '08: The Third National Summit on Equitable Development, Social Justice, and Smart Growth
Highlights the impact of policy efforts in urban, suburban, and rural communities. Topics include using equitable development tools and strategies to address poverty, restore cities, and create affordable housing.
March 5–7, 2008, New Orleans, La.
For information, see www.regionalequity08.org.

Reinventing Older Communities: How Does Place Matter? SAVE THE DATE!
This conference offers the latest thinking on how to reinvent cities, highlights innovative efforts, and shares insight on critical issues. Useful for both practitioners and policymakers. The third Reinventing conference organized by the Philadelphia Fed, it includes new "how to" and research tracks.
March 26–28, 2008, Marriott Philadelphia Downtown
Contact Jeri Cohen-Bauman at jeri.cohen-bauman@phil.frb.org for information.

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