Executive Summary*

From July 2007 through August 2009, 1.8 million homes were lost to foreclosure and 5.2 million more foreclosures were started. One in eight mortgages is currently in foreclosure or default. Each month, an additional 250,000 foreclosures are initiated, resulting in direct investor losses that average more than $120,000. These investors include the American people. The combination of federal efforts to combat the financial crisis coupled with mortgage assistance programs makes the taxpayer the ultimate guarantor of a large portion of home mortgages.

Each foreclosure further imposes direct costs on displaced owners and tenants, and indirect costs on cities and towns, and neighboring homeowners whose property values are driven down. High unemployment and depressed residential real estate values feed a foreclosure crisis that could pose an enormous obstacle to recovery.

The Panel is specifically charged with conducting oversight of foreclosure mitigation efforts under the Emergency Economic Stabilization Act (EESA). In particular, the statute directs the Panel to assess the effectiveness of the programs from the standpoint of minimizing long-term costs and maximizing benefits for taxpayers. To that end, the Panel asked Professor Alan White of Valparaiso University to conduct a cost-benefit analysis. Although federal foreclosure mitigation programs are still getting off the ground, the benefits of foreclosure modification are likely to outweigh the cost to taxpayers.

Since the Panel's March report on the foreclosure crisis, Treasury has unveiled its Making Home Affordable (MHA) initiative, the federal government's central tool to combat foreclosures. MHA consists of two primary programs. The Home Affordable Refinance Program (HARP) helps homeowners who are current on their mortgage payments but owe more than their homes are worth, refinance into more stable, affordable loans. The larger Home Affordable Modification Program (HAMP) reduces monthly mortgage payments in order to help borrowers facing foreclosure keep their homes. As of September 1, 2009, HAMP facilitated 1,711 permanent mortgage modifications, with another 362,348 additional borrowers in a three-month trial stage. HARP has closed 95,729 refinancings, hopefully reducing the number of homeowners who may face foreclosure in the future.

Treasury currently estimates it will spend $42.5 billion of the $50 billion in Troubled Asset Relief Program (TARP) funding for HAMP, which will support about 2 to 2.6 million modifications. If HAMP is successful in reducing investor losses, those savings should translate to improved recovery on other taxpayer investments. But if foreclosure starts continue their push toward 10 to 12 million, as currently estimated, the remaining losses will be massive.

*The Panel adopted this report with a 3-2 vote on October 8, 2009. Rep. Jeb Hensarling and Paul Atkins voted against the report. Additional views are available in Section Two of this report.

The Panel has three concerns with the current approach.

First is the problem of scope. Treasury hopes to prevent as many as 3 to 4 million of these foreclosures through HAMP, but there is reason to doubt whether the program will be able to achieve this goal. The program is limited to certain mortgage configurations. Many of the coming foreclosures are likely to be payment option adjustable rate mortgage (ARM) and interest-only loan resets, many of which will exceed the HAMP eligibility limits. HAMP was not designed to address foreclosures caused by unemployment, which now appears to be a central cause of nonpayment, further limiting the scope of the program. The foreclosure crisis has moved beyond subprime mortgages and into the prime mortgage market. It increasingly appears that HAMP is targeted at the housing crisis as it existed six months ago, rather than as it exists right now.

The second problem is scale. The Panel recognizes that HAMP requires a significant infrastructure–both at Treasury and within participating mortgage servicers–that cannot be created overnight. Foreclosures continue every day as Treasury ramps up the program, with foreclosure starts outpacing new HAMP trial modifications at a rate of more than 2 to 1. Some homeowners who would have qualified for modifications lost their homes before the program could reach them. Treasury's near-term target for HAMP – 500,000 trial modifications by November 1, 2009 – appears to be more attainable, but even if it is achieved, this may not be large enough to slow down the foreclosure crisis and its attendant impact on the economy. Once the program is fully operational, Treasury officials have stated that the goal is to modify 25,000 to 30,000 loans per week. Treasury's own projections would mean that, in the best case, fewer than half of the predicted foreclosures would be avoided.

The third problem is permanence. It is unclear whether the modifications actually put homeowners into long-term stable situations. Though still early in the HAMP program, only a very small proportion of trial modifications that were begun three or more months ago have converted into longer term modifications. In addition, HAMP modifications are often not permanent; for many homeowners, payments will rise after five years, which means that affordability can decline over time. Moreover, HAMP modifications increase negative equity for many borrowers, which appears to be associated with increased rates of redefault. The result for many homeowners could be that foreclosure is delayed, not avoided.

Whether current Treasury programs adequately address foreclosures also depends on the future condition of the housing market. Today, one-third of mortgages are underwater, and if housing prices continue to drop, some experts estimate that one-half of all mortgages will exceed the value of the homes they secure. Negative equity increases the likelihood that when these homeowners encounter other financial problems or when life events cause them to move, they may walk away from their homes and their over-sized mortgages. Others may be discouraged about paying off mortgages that greatly exceed the value of the property or give up their homes when they recognize that they would be ahead financially if they rented for a few years before

buying again. If left unresolved, redefaults and future defaults related to negative equity could mean that the country experiences high foreclosure rates and housing market instability for years to come.

While Treasury must consider programmatic changes to meet these challenges, so too must it adapt and improve the existing programs in several key ways.

Given the issues facing MHA, Treasury must be fully transparent about the effectiveness of its programs, as well as the manner in which they operate. Although Treasury's data collection has improved significantly since the Panel's March report, it should be expanded, and the information should be made public. Treasury should release its Net Present Value (NPV) model, which is used to determine a homeowner's eligibility for HAMP. The new denial codes should be implemented to provide borrowers with a specific reason for denying a modification and a clear path for appeal. Denial information should also be aggregated and reported to the public.

Treasury should also make the loan modification process more uniform so that borrowers, servicers, and advocates can more easily navigate the system. Uniform documents and more uniform processes would benefit both lenders and borrowers, and would make the program easier to administer and oversee. Treasury should continue its efforts to streamline the system, including through development of a web portal as suggested in the Panel's March report.

The model for determining borrowers' eligibility for the programs could be adapted to accommodate borrowers with arrearages and by incorporating more localized information when determining a mortgage loan's value.

In MHA, as in all of Treasury's programs, accountability is paramount. Servicers who fail to comply with the program's requirements should face strong consequences. Treasury must ensure that Freddie Mac, recently selected to oversee program compliance, has in place the proper processes to provide robust oversight. To further reinforce accountability, Treasury should continue to develop performance metrics and publicly report the results by lender or servicer.

Rising unemployment, generally flat or even falling home prices, and impending mortgage rate resets threaten to cast millions more out of their homes, with devastating effects on families, local communities, and the broader economy. Ultimately, the American taxpayer will be forced to stand behind many of these mortgages. The Panel urges Treasury to reconsider the scope, scalability and permanence of the programs designed to minimize the economic impact of foreclosures and consider whether new programs or program enhancements could be adopted.