Joint Oversight Hearing of the
Assembly Committee on Housing and Community Development and
Assembly Committee on Banking and Finance
Norma J. Torres and Mike Eng, Chair

"Keep Your Home California Program"

Monday, March 14, 2011 - 1:30 p.m.
State Capitol, Room 444

In February 2010, President Obama announced $1.5 billion in funding for innovative measures to help families in the states hardest hit by the aftermath of the burst of the housing bubble. As one of five states initially targeted for assistance, California was initially awarded close to $700 million under the federal Housing Finance Agencies Innovation Fund for the Hardest-Hit Housing Markets program (Hardest Hit Program). As explained below, that allocation has since been augmented to reach nearly $2 billion.

California Housing Finance Agency Hardest Hit Funds Programs. The California Housing Finance Agency (CalHFA), the state entity receiving the funds, was tasked with developing a program for California that met the basic guidelines outlined by the Obama Administration, including:

- Mortgage Modifications —Programs that provide modification of loans held by HFAs or other financial institutions or provide incentives for servicers/investors to modify loans.
- Mortgage Modifications with Principal Forbearance —Programs that provide paying down all or a portion of an overleveraged loan and taking back a note from the borrower for that amount in order to facilitate additional modifications.
- Short Sales/Deeds-In-Lieu of Foreclosure —Programs that provide assistance with short sales and deeds-in-lieu of foreclosure in order to prevent avoidable foreclosures.
- Principal Reduction Programs for Borrowers with Severe Negative Equity —Programs that provide incentives financial institutions to write down a portion of unpaid principal balance for homeowners with severe negative equity.
- Unemployment Programs —Programs that provide assistance to unemployed borrowers to help them avoid preventable foreclosures.
- Second Lien Reductions —Programs that provide incentives to reduce or modify second liens.

The program guidelines required CalHFA to submit its proposal to the U.S. Treasury Department (U.S. Treasury) for approval by April 16, 2010. To inform the proposal, CalHFA states that it met with loan servicers, loan counseling agencies, Fannie Mae, the general public, and other stakeholders to identify the greatest areas of need among at-risk borrowers. The program

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CalHFA developed, called Keep Your Home California, includes four separate programs to assist individual homeowners:

> Unemployment Mortgage Assistance Program (UMA) – Intended to assist homeowners who have experienced involuntary job loss. UMA provides temporary financial assistance in the form of a mortgage payment subsidy of varying size and term to unemployed homeowners who wish to remain in their homes but are in imminent danger of foreclosure due to short-term financial problems. These funds can provide up to six months of benefits with a monthly benefit of up to $3,000 or 100% of the existing total monthly mortgage, whichever is less.
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> Mortgage Reinstatement Assistance Program (MRAP) – Intended to assist homeowners who have fallen behind on their mortgage payments due to a temporary change in a household circumstance. MRAP will provide limited financial assistance in the form of funds to reinstate mortgage loans that are in arrears in order to prevent potential foreclosures. These funds can provide benefits of up to $15,000 per household.
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> Principal Reduction Program (PRP) – Intended to assist homeowners at risk of default because of an economic hardship coupled with a severe decline in the home's value. PRP will provide capital to reduce outstanding principal balances of qualifying borrowers with negative equity. Principal balances will be reduced in an effort to prevent avoidable foreclosures and promote sustainable homeownership. The principal reduction program will most likely be a prelude to loan modification. (In order for homeowners to receive assistance through PRP, their servicer must agree to contribute matching funds.)
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> Transition Assistance Program (TAP) – Intended to promote community stabilization by providing homeowners with relocation assistance when it is determined that they can no longer afford their home. TAP will be used in conjunction with a servicer-approved short sale or deed-in-lieu of foreclosure program in order to help homeowners transition into stable and affordable housing. Homeowners will be responsible to occupy and maintain the property until the home is sold or returned to the servicer as negotiated. Funds will be available on a one-time-only basis.

In order to qualify for any of the Keep Your Home California programs, a borrower must be low- or moderate-income; the programs can be used in combination, allowing a homeowner to receive up to $50,000 in assistance; borrowers cannot qualify if they have refinanced their home to take cash out.

During the process of developing its program, CalHFA received numerous suggestions from local governments, counseling agencies, financial advisors, and the general public. As a result of this input, CalHFA requested and received approval from the U.S. Treasury to set aside approximately $20 million for innovative approaches to foreclosure prevention. CalHFA received several proposals, selected the ones that qualified and submitted them to the U.S. Treasury for final approval. Two programs have been approved by the U.S. Treasury and will be discussed later.

On June 23, 2010, CalHFA received approval from the U.S. Treasury for the Keep Your Home California programs. On August 11, 2010, the Obama Administration announced that it would

be expanding the program from the original five states and giving the existing states more money. California received an additional $799.5 million in Hardest Hit funds. CalHFA also received approval to use $476.3 million in previously allocated foreclosure-prevention assistance for the Keep Your Home California programs, increasing the total available for the programs to nearly $2 billion. Since receiving federal approval, CalHFA has been developing its in-house servicing and working with loan servicers to get them signed on to the four programs.

Below is a chart of the servicers that have signed on to at least one of the four programs:

SERVICER	UMA	MRAP	PRP	TAP
CalHFA	X	X	X	X
Chase Home Finance LLC	X	X		
JP Morgan Chase Bank, NA	X	X		
EMC Corporation	X	X		
CA Department of Veterans Affairs	X	X	X	X
GMAC (Ally)	X	X	X	X
Wells Fargo	X	X		
Bank of America	X			
CitiMortgage	X	X		

Below is a chart of the estimated amount of assistance that CalHFA anticipates offering in each of the four programs and the number of households it estimates could be assisted:

Program	**Allocated Program Funds**	**# of Households**
UMAP	$875 million	60,500
MRAP	$129 million	9,200
PR	$790 million	23,135
TAP	$32 million	6,470

*Funds may be reallocated based on results

CalHFA began offering the four programs on a pilot basis to its own portfolio of borrowers in the fall of 2010. On January 10, 2011, CalHFA launched the Unemployment Mortgage Assistance Program statewide. On February 7, 2011, CalHFA launched the other three programs (the Mortgage Reinstatement Assistance Program, the Principal Reduction Program. and the Transitional Assistance Program) statewide.

Implementation Challenges Facing The CalHFA Program**.** Among the challenges implementing the Keeping Your Home California Program have been:

- CalHFA developed an in-house servicing department that required hiring and training new staff;
- CalHFA needed to develop a secure method of exchanging confidential information about non-CalHFA borrowers with loan servicers; and

- The Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac, do not participate in principal reduction programs and they own a large percentage of California mortgages, which has been a barrier to getting banks to sign on to the PRP.

Controversy Regarding Principal Reduction Programs. Banks have largely resisted principal reductions. According to published reports "two of the biggest players in the mortgage market – JP Morgan and Wells Fargo – are open about their dislike of this tactic for modifying mortgages. They said so at an April 2010 hearing before the House Financial Services Committee. The two other big banks, Citigroup and Bank of America were mum on the subject, though Bank of America did start a small program to begin principal reductions in March."

"It's easy to understand why big banks fear principal reductions – they will create big, immediate losses. According to its 2010 first quarter report, JPMorgan lists $247 billion in mortgages and home equity loans on its balance sheet. Of that $79 billion are considered "impaired," bought through its Washington Mutual acquisition. The report indicates that the charge-off rate for non-impaired loans is running at 4.9%, while their delinquency rate is at 7.3%. Meanwhile, its impaired portfolio's delinquency rate is 28.5%. If JPM started writing down a lot of principal from its portfolio to modify loans, then some very large losses would result very quickly, given these ugly statistics." (Congressional Oversight Panel Assails HAMP, The Atlantic Monthly, April 14, 2010.)

Additionally, Fannie Mae and Freddie Mac appear to be resistant to allow entities that service their loans from doing any principle reduction on their portfolio. The third quarter OCC and OTS Mortgage Metrics Report reveals that on loans where Fannie Mae and Freddie Mac are the investor, principal reduction has not been used as a loan modification option. This is a significant obstacle, considering that they are some 80 percent of the mortgage market

Local Innovation Programs:

Los Angeles Program Administered by One LA. One LA-IAF a Los Angeles-based non-profit organization, has initiated a principal reduction program. One LA is a dues-paying member institutions committed to building power for sustainable social and economic change. One LA-IAF is affiliated with the Industrial Areas Foundation (IAF), a national organizing and leadership development network. The members of One LA-IAF are institutions: congregations, schools (both private and public), labor unions, non-profits and neighborhood organizations that share a concern for families and are rooted in traditions of faith and democracy.

One LA has partnered with Neighborhood Legal Services of LA County to launch a foreclosure prevention plan that has been endorsed by the City of Los Angeles, with $1 million allocated to demonstrate partnering between borrowers, banks, and public sector designed to prevent foreclosure against 50% of people that would otherwise have lost homes. Neighborhood Legal Services and One LA are negotiating with Bank of America and Chase to utilize their strategy to write down loan principal to achieve a sustainable loan modification.

The Keep Your Home Los Angeles foreclosure program has also been awarded $10 million by CalHFA (with an initial release of $5 million), subject to Treasury Department

approval, to help Los Angeles homeowners with severe negative equity modify their home mortgages. Under the program, a small amount of funds is used to pay down "under water" mortgage principal. The payment is in the amount of the Net Present Value, or current value, of the principal. In the alternative, the payment is in the amount consistent with a schedule established by the U.S. Department of Treasury, of .06 to .21 cents per dollar of principal reduction, depending on how delinquent the loan and how far "under water" the mortgage. The program limits total mortgage debt after modification to 125% of a home's current market value. According to One LA the program was vetted by financial analysts within major banks, as well as a volunteer banking expert, the U.S. Treasury and Secretary of HUD, Shawn Donovan and was found to be favorable to both homeowners and investors. It is believed that One LA-IAF has not completed any modifications to date.

Bank of America reportedly committed to a similar $1 million program in April 2010 to assist approximately 50 residents of the Los Angeles City 6th and 7th Council districts, although no modifications are known to have been completed at this time.

The Community Second Mortgage Principal Reduction Program (C2MPRP). The Community Second Mortgage Principal Reduction Program (C2MPRP), has been selected by CalHFA and approved by the US Treasury for a total of $10M under CalHFA's larger TARP programming, which includes Keep Your Home by CalHFA MAC. The C2MPRP is designed to provide principal reductions for California homeowners experiencing hardship, who have a second mortgage in repayment that is held by a non-profit lender; such as a credit union or community development financial institutions.

The goal of this program is to reduce foreclosures by reducing principal balances, on qualified amortizing second mortgages, to the market levels needed to prevent avoidable foreclosures, and promote sustainable homeownership. The C2M PRP thus provides an incentive for qualifying homeowners to remain in their homes during this period of steep declines in value, in situations when existing Making Home Affordable and CalHFA programs are unable to do so. This program also serves as an incentive for smaller community lenders to write-off 65% of the overall reduction, in exchange for 35% of the total principal reduction – which can be reinvested back into their communities in the future.

Struggling homeowners under 120% of the median income will; fully document their finances to demonstrate hardship and inability to pay the full mortgage amount, have a combined loan to value ratio over 115%, be occupying the property, attempt a modification of their 1st mortgage as well, and document enough income to sustain the home going forward. In addition, the home cannot be subject to a trustee sale, the homeowner must not own any other real estate or owe more on the existing home than $729,440. This program cannot be used in conjunction with any other Treasury second lien program or the KYHC programs by CalHFA.

The maximum amount per household is $50,000, with average amounts of $25,000, and the program is anticipated to reach 440 homeowners across the state, and within hundreds of small credit unions and community lenders.

Current State of the California Real Estate Market, Mortgage Defaults and Foreclosure Activity

Current Conditions. Nationwide, over two and half million homes are in some stage of foreclosure. A total of more than 3.8 million foreclosure filings -- default notices, scheduled auctions and bank repossessions -- were reported on a record 2.87 million U.S. properties in 2010, according to a January 2011 report by RealtyTrac, Inc**.** The number of filings was an increase of nearly 2 percent from 2009 and an increase of 23 percent from 2008.

According to RealtyTrac, a total of 546,669 California properties received a foreclosure filing in 2010, a decrease of nearly 14 percent from 2009 but still the largest state total. After hitting a two-year low in November, California foreclosure activity rebounded nearly 15% higher in December but was still down 18% from December 2009. (The charts attached in the Appendix to this paper provide more detail on 2010 California data.)

Observers have noted that the numbers would have been much higher were it not for the decision of several major banks to slow foreclosures dramatically late last year amid concerns regarding the adherence to proper foreclosure filing procedures across the nature.

Federal, State and Industry Responses to Homeowner Defaults and Foreclosures

A. Federal Efforts.

The federal "Making Home Affordable Program" was developed by the U.S. Department of the Treasury, at the urging of President Obama, in order to help borrowers avoid foreclosure.

Home Affordable Modification Program. In 2008, the president signed and enacted the Emergency Economic Stabilization Act. This legislation granted Treasury the opportunity to create the Troubled Asset Relief Program (TARP). In 2009, Treasury allocated $50 billion in TARP funds to implement the Home Affordable Modification Program (HAMP).

HAMP relies on financial incentives to servicers to modify mortgages for homeowners as well as beneficiaries of these modifications to stay current on their mortgage payments going forward. When a servicer qualifies for HAMP, the lender must first reduce monthly payments until they are no more than 38% of the borrower's gross monthly income and then the Treasury will match, dollar for dollar, further reductions required to bring the monthly payments down to 31% of the borrower's income.

Borrowers may be eligible for HAMP if:

1) the home is owner-occupied, not vacant and not condemned;

2) the remaining balance on the home does not exceed $729,750;

3) the borrower is delinquent or in default;

4) the borrower demonstrates financial hardship; and

5) the borrower has a monthly debt-to-income ratio of more than 31% (meaning the monthly mortgage payment must be greater than 31% of the borrower's grossly monthly income.)

If a borrower if eligible for HAMP, the borrower must successfully complete a three month trial period. A borrower who remains current through the trial period becomes eligible for a permanent modification. As of October 3, 2010, 105 servicers enrolled in HAMP covering nearly 90% of all non-GSE mortgage loans.

HAMP will only continue to make trial modifications until the end of 2012. In addition, the Treasury as of October 3, 2010 can no longer make programmatic changes to HAMP nor will any additional TARP money be allocated to the program.

It is important to note that HAMP modifications are not the only option available to borrowers. First, a large number of loans are not eligible for HAMP based on the type of loan or the borrower's characteristics. Even in those cases where a borrower may not qualify for HAMP, many servicers do offer their proprietary modification programs. The nature of proprietary loan modifications offered by servicers vary by servicer and by loan characteristics so proprietary loan modifications are not standardized across the industry, as opposed to the standardization of HAMP. Servicers that participate in HAMP must first determine if a borrower is eligible for HAMP before considering them for a proprietary loan modification. Often lost in the discussion of loan modifications is that the ability to get a modification, or the type of modification offered, may reach beyond simple borrower qualifications. Investors may be required to give approval for certain modification approaches, and some loans by their nature are more apt for specific modification actions. For example, the growth of prime loan defaults has reportedly been problematic to address because prime loans may have less modification flexibility because they lack the features of non-prime loans, such as adjustable payments, that would allow quick changes to monthly payments.

Other Federal Foreclosure Mitigation Programs

Home Price Decline Protection (HPDP). Effective on July 31, 2009, designed to address the issue of investor objections to modifications due to the fear of declining home values. Investors receive incentive payments that accrue over a 24-month period to mitigate potential losses and encourage consent to proposed modifications.

Principal Reduction Alternative (PRA). Effective October 1, 2010, this program provides principal forgiveness. Servicers are required to evaluate a loan that is eligible for HAMP and has a mark-to-market loan-to-value ratio greater than 115%. Final decision on whether to grant a reduction is the servicers. Investors receive incentive payments as well as a percentage of each dollar forgiven.

Home Affordable Unemployment Program (UP). Effective July 1, 2010, this program assists unemployed homeowners by granting a temporary forbearance of a portion of their monthly mortgage payment for a minimum, the lesser of three months or until employment is regained.

During the forbearance period, payments are reduced to no more than 31% of the borrower's grossly monthly income, including unemployment benefits.

Home Affordable Foreclosure Alternatives (HAFA). Effective on April 5, 2010, this program was created to encourage the use of short sales and deeds-in-lieu of foreclosure for HAMP-eligible borrowers unable to qualify for modifications of currently underwater mortgages. Servicers agree to forfeit the ability to seek a deficiency judgment in exchange for borrowers engaging in short sales or issuing deed-in-lieu of foreclosures. All parties receive financial incentives in the form of relocation assistance, one-time completion, and reimbursement to release subordinate liens.

Second Lien Modification Program (2MP). Effective August 14, 2000, this program allows borrowers to apply for a modification on their second loan if their first loan has been modified. ALL 2MP modifications must consist of: an interest rate reduction, an extension of term years matching the first loan modification, and principal forbearance or reduction matching the percentage of any principal forbearance or reduction on the first loan.

FHA Short Refinance Program. Effective on September 7, 2010, this program allows borrowers to refinance non-FHA insured underwater mortgages into above-water, FHA insured mortgages. Eligible borrowers are not guaranteed a refinance and program participation is voluntary for servicers on a case-by-case basis.

Loan Modification Challenges That Could Impact the Keeping Your Home California Program.

Loan modification programs present many unique challenges. Some of these issues are subject to vigorous debate, while others are identified and acknowledged by all sides. All of the factors that fed the engine of mortgage growth prior to the subprime collapse and made credit easy for consumers to acquire, are now the things that make loan modifications difficult. Securitization, investor decisions, the nature of servicing, and a host of other unseen dynamics can play a potential role in making otherwise effective programs on paper, fall short in "real-world" application. This is not to say that policy makers, regulators nor industry groups should resign themselves mediocrity. Instead, as these groups become aware of these challenges, proactive problem solving may be able to assist in foreshadowing these problems with KYHC Program, and improving its odds of success. With hundreds of reports, media articles, policy committee hearings at the state and federal level the problems associated with loan modifications are documented. In an attempt to forecast, or at the least raise awareness about these potential pitfalls, below is a brief summary of issues that have faced loss mitigation programs, and could impact KYHC.

- *Borrower contact fatigue*: In order to make a program work, borrower outreach and contact is vital. As numerous accounts demonstrate the most difficult step to getting the modification process started, is making contact with a distressed borrower. In some cases, a borrower may not be responsive to a servicer through which they have already had a bad experience, either through collections activity, or through previous loan modification attempts. Additionally, mailings and phone calls may be confused for unwarranted

solicitations regarding other financial services.

- *Transmission and permeation of incorrect information*: Many borrowers in an effort to seek assistance may reach out to loan modification companies that have little to no actual experience, or seek counsel from family and friends that leads to incorrect assumptions about qualification or ability to seek a loan modification. Media has also played a role in this problem, as short snippets regarding the eligibility of various programs can lead borrowers to assume that they qualify without knowing the actual requirements.

- *Loan type*: Early in the subprime crisis, the loans that were doing the most damage were non-traditional loans that included rate and/or payment adjustments that would the leave borrowers unable to afford their mortgage. These loans were easier in some ways to modify because they had more features that could be adjusted to reach an affordable payment. While many of these loans still exist, more and more 30 year fixed rates loans are defaulting. These loans present several challenges as they don't have as many features to modify, or they tend to be owned by the GSEs (more on that later), which can make certain types of medication more difficult.

- *Investors:* For loans sold into the secondary market, investor decision making is a major obstacle in the loan modification process. This obstacle can come from delay in granting a servicer permission to modifying a loan, down to broad prohibitions on modification, or the type of modification that can be offered. This is can have a negative impact on borrowers who may learn that their servicer participates in a specific program, but later learn that the investor in their loan does not authorize that program-specific type of modification.

- *Servicing*: Loss mitigation strategies require customer service skills and often one-on-one attention that doesn't benefit from the automation model that servicing has traditionally operated under. The servicing model also confuses borrowers who may not understand that the entity that owns their loan and the servicer are most often not the same entity and have different roles and motivations. Furthermore, consumer groups and academic experts have argued that the servicing model may lead to incentives that make modification difficult.

- *Sustainability*: The characteristics of a loan modification that is sustainable for borrowers is still the subject of vigorous debate. The magic number, at least for HAMP and numerous other programs, seems to be a mortgage payment that is no more than 31% debt to income ratio. For HAMP, this ration is determined based on housing expenses but does not look at other debts such as credit cards, or even car payments. A 31% DTI for a borrower with large credit card debt may not be sustainable or even realistic. In addition, DTI ratios are not the only point of debate. There still exist a debate between industry and consumer organizations regarding the types of modifications that lead to

sustainably mortgages. Some may see extending the length of a loan as sufficient to bring down monthly payments, while others may see interest rate reductions as the solution, or even a combination of both. Other advocates believe that principal reduction is the best way to reach affordability. However, even if one can arrive at the conclusion that principal reduction is one tool in the modification tool-box, then disagreements arise as to how such an approach would work as everyone seems to have a different view on how much principal reduction is enough.

- *Second Liens*: Servicers also service second lien mortgage loans, further complicating the loan modification process. Attempted loan modifications where a second lien exists become difficult because the second lien holder must agree to the modification and possible extinguishment of their lien holder rights when they stand to make no benefit. Junior lien holders have been slow and reluctant to agree to re-subordinate in this episode and have held up refinancing, modifications, and short sales.

- *Fannie Mae and Freddie Mac (GSEs)*: In the principal reduction debate, many have pointed out that the GSEs do not allow principal reduction on the loans that they own. With 80% of the market owned by the GSE's this has the potential to severely limit relief via principal reduction strategies. Furthermore, the future of the GSEs in the mortgage market is currently the subject of review and discussion at the federal level, further putting political pressure on the GSEs where otherwise their energies might better be focused elsewhere. Finally, conflicting messages from Federal regulators impose unique challenges. While the GSEs are private companies, they are afloat due a massive infusion of federal dollars. Federal policy on modifications is realized via HAMP and other federal modification programs. However, the GSEs late last year put additional pressure on servicers to expedite foreclosures (**Fannie Mae gets tougher on U.S. mortgage servicers-- *Reuters* 09/01/2010)**

The aforementioned list is not meant as an exhaustive representation of all of the potential obstacles to success for loan modification programs. It is only an attempt to briefly summarize some key issues.