



# SIGTARP

OFFICE OF THE SPECIAL INSPECTOR GENERAL  
FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

## **FACTORS AFFECTING IMPLEMENTATION OF THE HOME AFFORDABLE MODIFICATION PROGRAM**

**SIGTARP-10-005  
MARCH 25, 2010**



# SIGTARP

Office of the Special Inspector General  
for the Troubled Asset Relief Program

## Summary of Report: SIGTARP-10-005

### Why SIGTARP Did This Study

In response to millions of families potentially facing foreclosure in the next several years, on February 18, 2009, the President announced the Making Home Affordable (“MHA”) program to assist struggling homeowners. As part of this effort, on March 4, 2009, the U.S. Department of the Treasury (“Treasury”) announced the \$75 billion Home Affordable Modification Program (“HAMP”) to assist homeowners by lowering their monthly payments through mortgage modifications. Of the \$75 billion allocated for HAMP, \$50 billion comes from the Troubled Asset Relief Program (“TARP”) to modify privately-owned mortgages. More than a year after announcement of the program, disappointing results have raised questions about program effectiveness.

This report addresses (1) HAMP’s status and whether the program has met participation goals thus far and (2) what challenges have confronted and continue to confront Treasury in implementing the program. To complete our audit, SIGTARP reviewed HAMP policies, procedures, and marketing materials of Treasury, Fannie Mae, Freddie Mac, and a sample of five servicers performing modifications and interviewed officials at those organizations. This audit focuses only on Treasury’s performance, and not that of the servicers. Our work was performed in accordance with generally accepted government auditing standards.

### What SIGTARP Recommends

SIGTARP recommends that Treasury (a) prominently disclose its goals for how many homeowners will actually be helped through permanent modifications and track performance against those goals; (b) set goals for other performance metrics and report performance against those goals; (c) undertake a sustained public service announcement campaign as soon as possible both to reach additional borrowers that could potentially be helped by the program and to arm the public with complete, accurate information about the program; (d) reconsider its decision to allow servicers to substitute alternative forms of income verification; and (e) re-examine the program’s structure to ensure that the program is adequately minimizing the risk of re-default.

In commenting on a draft of this report, Treasury stated that it concurred with SIGTARP’s first three recommendations and non-concurred with the last two recommendations. A fuller discussion of Treasury’s response is contained in the *Management Comments and Audit Response* section of this report.

March 25, 2010

## Factors Affecting Implementation of the Home Affordable Modification Program

### What SIGTARP Found

When HAMP was launched in the first few months of 2009, Treasury justified the program by stating that it would “help up to 3 to 4 million at-risk homeowners avoid foreclosure,” and that it would do so “by reducing monthly payments to sustainable levels.” Notwithstanding this laudable aspiration that the program would *actually help* 3 to 4 million homeowners avoid foreclosure, Treasury has stated its 3 to 4 million homeowner goal is not tied to how many homeowners actually receive sustainable relief and avoid foreclosure, but rather that 3 to 4 million homeowners will receive *offers* for a trial modification. Measuring trial modification offers, or even actual trial modifications, for that matter, is simply not particularly meaningful. The goal that should be developed and tracked is how many people are helped to avoid foreclosure and stay in their homes through permanent modifications. Transparency and accountability demand that Treasury establish goals that are meaningful, and that it report its progress in meeting such meaningful goals on a monthly basis. Continuing to frame HAMP’s success around the number of “offers” extended is simply not sufficient.

A year into the program, although more than a million trial modifications have been initiated, the number of permanent modifications thus far, 168,708, has been, even according to Treasury, “disappointing.” One Treasury official’s current estimate for how many permanent modifications will result from HAMP — 1.5 to 2 million over the course of the four-year program — may be only a small fraction of the total number of foreclosures that will occur during that period. It is the current projected estimate of permanent modifications (and not Treasury’s still repeated 3 to 4 million figure) that should inform the debate on whether HAMP is worth the resources being expended or whether the program needs to be re-vamped to actually help more borrowers.

There are several reasons that have been identified for the disappointing results:

- (a) program rules had not been fully developed by the time the program began, and Treasury has had to revise guidelines repeatedly, causing confusion and delay;
- (b) Treasury’s decision to permit servicers to start trial modifications before receiving supporting documentation has been counterproductive, creating a large backlog of trial modifications, of which many will never become permanent; and (c) Treasury’s marketing efforts thus far have been limited, with an inexplicable absence of its own television public service announcements a year into the program.

Looking forward, even if HAMP results in the estimated 1.5 to 2 million permanent modifications, the program will not be a long-term success if large amounts of borrowers simply re-default and end up facing foreclosure anyway. Several aspects of HAMP’s design make it particularly vulnerable to re-defaults. First, a borrower’s non-mortgage debts (which could prevent a homeowner from staying current on even modified mortgage payments) are neither factored into the modified payment calculation nor will they exclude borrowers from participating in HAMP. Second, borrowers may be unable to meet the increasing monthly payments if their income has not increased commensurate with the interest rate adjustments that begin once the five-year modification period is concluded. Third, even if borrowers receive a HAMP permanent modification on their first lien, for the estimated 50 percent of at-risk borrowers, the total monthly mortgage payments might still be unaffordable if the second lien is not also modified or extinguished; only recently has Treasury been able to sign up servicers to Treasury’s second lien program. Finally, given the prevalence of negative equity in mortgages eligible for modification, re-defaults resulting from negative equity, including strategic defaults, may be a factor as borrowers decide that it makes more economic sense for them to walk away from their mortgages notwithstanding the lower payments.



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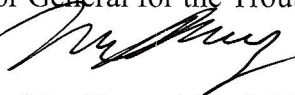
FOR THE TROUBLED ASSET RELIEF PROGRAM

1801 L STREET, NW

WASHINGTON, D.C. 20220

MAR 25 2010

MEMORANDUM FOR: The Honorable Timothy F. Geithner, Secretary of the Treasury

FROM: Neil M. Barofsky, Special Inspector General for the Troubled Asset Relief Program (SIGTARP) 

SUBJECT: Factors Affecting Implementation of the Home Affordable Modification Program (SIGTARP-10-005)

We are providing this audit report for your information and use. It discusses the status of HAMP, the current challenges facing HAMP, Treasury's plans to address these challenges, and methods Treasury uses to market HAMP. The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") conducted this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general of the Inspector General Act of 1978, as amended.

We considered comments from the Department of the Treasury when preparing the final report. The comments are addressed in the report, where applicable, and a copy of the comments is included in the Management Comments appendix of this report.

We appreciate the courtesies extended to the SIGTARP staff. For additional information on this report, please contact Mr. Kurt Hyde, Deputy Special Inspector General for Audit ([202-622-4633](tel:202-622-4633)/[kurt.hyde@do.treas.gov](mailto:kurt.hyde@do.treas.gov)).

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## **FACTORS AFFECTING IMPLEMENTATION OF THE HOME AFFORDABLE MODIFICATION PROGRAM**

**SIGTARP REPORT 10-005**

**MARCH 25, 2010**

### **Introduction**

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Home foreclosures can have a devastating impact not only on the families losing their homes, but also on the communities affected and on mortgage lenders. Families can potentially face economic challenges and homelessness after losing what is typically their most important asset and investment; communities suffer from the downward drag on property values that vacant, foreclosed-upon houses represent; and mortgage lenders and investors not only lose their receipt of monthly house payments but are often left with the difficult choice of selling the home at fire sale prices or incurring substantial maintenance expenses. Unfortunately, these negative effects have been widely felt during the current financial crisis, with foreclosures in many areas of the country reaching historic proportions. More than two million homeowners received foreclosure filings in 2008; nearly 2.8 million homeowners received foreclosure filings in 2009, and millions more are expected in 2010, with some estimates predicting that the number will eclipse the already staggering 2009 number.

With the foreclosure crisis as background, Congress made foreclosure mitigation an express part of the Emergency Economic Stabilization Act of 2008 (“EESA”), the statute that created the Troubled Asset Relief Program (“TARP”). Among other things, preserving homeownership is an explicit purpose of EESA, and “the need to help families keep their homes and to stabilize communities” is one of the considerations that the Secretary of the Treasury must take into consideration in exercising his authorities under EESA.

In February 2009, the United States Department of the Treasury (“Treasury”) announced several home preservation initiatives under the broad Making Home Affordable (“MHA”) program, including the Home Affordable Modification Program (“HAMP”). HAMP is a \$75 billion program that includes \$50 billion from TARP for the modification of privately-owned mortgage loans. More than a year has now passed since HAMP was announced, and this audit examines the program’s status and limited successes thus far. This report is a review of the actions Treasury has taken to implement HAMP and is not an audit of servicers. The information garnered from our conversations with servicing officials was used as supplemental information to further inform our assessment of HAMP’s status and challenges.



## Objectives

The objectives of this audit are to determine the status of HAMP and what challenges have been faced in HAMP's implementation. Specifically, we will answer the following questions:

What is the status of HAMP, and has the program met its goals for participation thus far?

What challenges have confronted and continue to confront Treasury in implementing the program?

SIGTARP will issue separate reports on HAMP's internal controls and on servicers' compliance with Treasury's net present value test, and will soon announce additional audit work on HAMP's compliance program.

For a discussion of the audit scope and methodology and a summary of prior coverage, see Appendix A. For a description of HAMP stakeholders' roles and responsibilities, see Appendix B. For a description of how the HAMP net present value test model has changed over the course of the program, see Appendix C. For definitions of acronyms used in this report, see Appendix D. For a list of audit team members, see Appendix E. For management comments, see Appendix F.

## Background

HAMP is designed to encourage loan servicers to modify eligible mortgages so that the monthly payments of homeowners who are currently in default or are in imminent risk of default will be reduced to affordable levels. Loan servicers are not required to participate in the program, but HAMP encourages servicers to make such modifications by sharing some of the costs associated with the modification and by making incentive payments based upon successful modifications. Once servicers sign a Servicer Participation Agreement, servicers are required to offer HAMP modifications to all eligible borrowers.

Treasury signed fiscal agent agreements with the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") to act as Administrative Agent and Compliance Agent, respectively, for HAMP. In addition, Fannie Mae and Freddie Mac are required to modify eligible mortgages that they own or guarantee. The Administration estimated, at the time HAMP was announced in February 2009, that the cost to Fannie Mae and Freddie Mac of modifications of loans they own or guarantee could be up to \$25 billion.

Actual execution of the program lies in large part with participating mortgage servicers whose employees are responsible for the offering and processing of modifications. As of the end of January 2010, 110 servicers signed agreements to participate in the privately-owned mortgage portion of HAMP with servicer success and performance varying. Other entities have additional

roles and responsibilities for implementing HAMP. See Appendix B for the key HAMP stakeholders and descriptions of their roles and responsibilities.

This background section briefly describes (a) HAMP's eligibility requirements, (b) the basic structure of how the terms of modifications are determined, (c) the incentive payment structure, and (d) other programs that facilitate or operate in lieu of HAMP modifications.

### *HAMP Eligibility*

One financial eligibility requirement under HAMP is that a borrower must either be in default of his or her loan — 60 or more days late on their mortgage payments — or be at risk of imminent default. Risk of imminent default is defined as a borrower who is current on his or her mortgage payments, or is less than 60 days delinquent but faces the possibility of future default because of a change in financial circumstances, such as through an interest rate reset, unemployment, or some other reason that has made it difficult for the homeowner to continue meeting his or her monthly payments at the existing level. In addition to meeting these criteria, a borrower's mortgage must meet other eligibility criteria to receive a HAMP modification on his first lien.<sup>1</sup> Table 1 lists the additional eligibility criteria. Mortgages that have been securitized<sup>2</sup> may require modifications to be approved by investors and, as discussed briefly below, a separate program has been initiated to deal with second liens. Although not an eligibility criterion, any foreclosure action will be suspended during a trial period or during consideration for foreclosure alternatives. Foreclosure may resume if a modification effort fails.

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<sup>1</sup> A lien is a form of security interest granted over an item of property to secure the payment of a debt or performance of some other obligation. The first lien takes priority over all other encumbrances over the same property.

<sup>2</sup> Securitization is a process where financial assets are packaged together into securities that are sold to investors. A mortgage pooling and servicing agreement describes how pooled loans will be serviced and dictates how proceeds and losses will be distributed among bondholders. Some agreements limit or prevent servicers from making modifications to mortgages. For a more detailed description of securitization, see SIGTARP's April 21, 2009 Quarterly Report to Congress, with the discussion beginning on page 92.

**Table 1—Additional Criteria Used to Determine if a Mortgage is Eligible for a HAMP Modification**

Origination Date	Mortgage must have originated on or before January 1, 2009.
Qualification Terms	<p>The home must be owner occupied and a single family 1-4 unit property with a maximum unpaid principal balance of:</p> <ul style="list-style-type: none"> <li>• 1 unit – \$729,750</li> <li>• 2 unit – \$934,200</li> <li>• 3 unit - \$1,129,250</li> <li>• 4 unit - \$1,403,400</li> </ul> <p>The home must be the borrower’s primary residence.  The home may not be investor-owned.  The home may not be vacant or condemned.  Borrowers in bankruptcy are not automatically eliminated from consideration.  Borrowers in active litigation regarding the mortgage may qualify without waiving their legal rights.</p>

Source: Home Affordable Modification Program Guidelines, March 4, 2009.

If a mortgage meets these eligibility criteria, the servicer will undertake a “net present value test” to determine whether it will modify the mortgage, seek a foreclosure alternative, or pursue foreclosure. Several loan characteristics are input into Treasury’s net present value model, with a resulting positive or negative numeric value. These inputs include the location of the home, the value of the mortgage, the homeowner’s credit score, the homeowner’s front-end debt-to-income ratio, and the loan’s delinquency status. Participating servicers are required to offer a HAMP modification to a borrower qualifying for a modification based on the other program criteria if the model generates a positive value, which indicates that it is economically advantageous to modify the loan; *i.e.*, the modification will cause less loss to the owner of the mortgage than proceeding with foreclosure.<sup>3</sup>

*Modification Terms*

Treasury made the decision, based on certain industry standards, that an affordable mortgage would have a mortgage debt-to-income ratio of 31 percent, meaning that the total monthly mortgage payment will be no more than 31 percent of the homeowner’s monthly gross income. If a borrower meets the eligibility criteria and the net present value model yields a positive value, the servicer follows HAMP’s “waterfall” (shown in table 2) in order to design a modification that will result in a debt-to-income ratio of 31 percent. Servicers apply the modification steps in the stated order until the borrower’s debt-to-income ratio is reduced as closely as possible to 31 percent without going below.<sup>4</sup>

<sup>3</sup> Loans that are owned or guaranteed by the government sponsored enterprises, on the other hand, are modified if the net present value model results are equal to or greater than a negative \$5,000.

<sup>4</sup> Servicers are not precluded under HAMP from agreeing to a modification that reduces the borrower’s monthly mortgage payment ratio below 31 percent as long as the modification otherwise complies with the HAMP requirements. Similarly, and where permitted by the applicable servicing agreement or contract, servicers are not precluded from agreeing to a modification where the interest rate does not step up after five years, or where additional principal forbearance is substituted for extending the term as needed to achieve the target monthly mortgage payment ratio of 31 percent.



**Table 2—HAMP’s Waterfall Steps**

<b>Step One</b>	<p>Capitalize all outstanding interest, escrow advances, and third-party fees.</p> <p>Late fees are to be waived for a borrower who satisfied conditions for a trial modification.</p>
<b>Step Two</b>	<p>Reduce the mortgage interest rate in increments of 0.125 percent with a floor of two percent.</p> <p>If the loan is a fixed rate or adjustable-rate mortgage, the current interest rate is used as starting point.</p> <p>If the mortgage is a resetting adjustable-rate mortgage, the starting point will be the reset interest rate.</p>
<b>Step Three</b>	<p>The term of the mortgage can be extended to 480 months from the modification effective date.</p> <p>If the pooling and servicing agreement does not allow an extension, the mortgage may be re-amortized based upon 480 months with a balloon payment due at maturity.</p> <p>Negative amortization is prohibited after the effective date of the modification.</p>
<b>Step Four</b>	<p>Provide non-interest bearing and non-amortizing principal forbearance.</p> <p>This forbearance amount will result in a balloon payment fully due upon maturity of the loan, upon payoff of the interest bearing portion of loan, or the transfer of the property to another party.</p> <p>Principal forgiveness is not required under HAMP; however, servicers may forgive principal to achieve the debt-to-income ratio goal of 31 percent on a standalone basis or before any of the previous steps.</p> <p>If principal is forgiven before step one through three, no subsequent step in the waterfall may be skipped.</p> <p>If the interest rate is not reduced after principal forgiveness, the existing rate will be fixed and treated as the modified interest rate.</p>

Source: Treasury, Supplemental Directive 09-01, April 6, 2009.

After April 15, 2010, borrowers who fully qualify for a modification and submit the required documentation enter a trial period. Before then, trial modifications could be made without documentation. The trial period lasts 90 days<sup>5</sup> and includes three modified mortgage payments, but can last longer if necessary to comply with investor contractual obligations. If the borrower is current at the end of the trial period and all documents have been received by the servicer, the borrower will be offered a permanent modification.

<sup>5</sup> On August 26, 2009, Treasury announced a temporary waiver to allow an extension of up to two months for all trial periods so borrowers could submit all required documentation. A second two-month extension occurred on November 18, 2009, and then a third for one month with the conversion campaign detailed in Supplemental Directive 09-10 on December 23, 2009. This waiver was later amended to provide for an extension through December 31, 2009.

### *Incentive Payments*

To encourage participation in the program, Treasury pays incentives using TARP funds. First, Treasury shares some of the economic cost of the modification. If a servicer makes modifications to get a homeowner down to a 38 percent mortgage debt-to-income ratio, Treasury will provide 50 percent of the costs of modification to get the loan from 38 percent to the target 31 percent debt-to-income ratio. Such payments are made once the modification becomes permanent and lasts for up to five years or until the loan is paid off, whichever is earlier.

Second, Treasury makes incentive payments for successful modifications. These incentives are targeted toward the three main participants in the mortgage modification process — the homeowners who stay current on their mortgages after a modification, the mortgage servicers who establish successful modifications, and the investors who own the mortgage loans. Table 3 describes incentive payments made for successful HAMP modifications.

**Table 3—HAMP Incentive Payments**

<b>Servicer Incentive Payments and Pay for Success Fees</b>	Servicers will receive an up-front incentive payment of \$1,000 for each permanent modification. They will also receive pay for success payments — as long as the borrower stays in the program — of up to \$1,000 each year for up to three years.
<b>Borrower Pay-for-Performance Success Payments</b>	Borrowers are eligible to receive a pay-for-performance success payment that goes straight towards reducing the principal balance on the mortgage loan as long as the borrower is current on his or her monthly payments. Borrowers can receive up to \$1,000 of success payments each year for up to five years.
<b>Current Borrower One-Time Bonus Incentive</b>	One-time bonus incentive payments of \$1,500 to investors and \$500 to servicers will be provided for modifications made while a borrower is still current on mortgage payments, but in danger of imminent default. The servicer will be required to maintain records and documentation evidencing that the trial period payment arrangements were agreed to while the borrower was less than 30 days delinquent.
<b>Investor Incentives</b>	This compensation equals one-half of the dollar difference between the borrower’s monthly payment at 31 percent and the lesser of (i) what the borrower’s monthly payment would be at a 38 percent; or (ii) the borrower’s pre-modification monthly payment. This incentive lasts up to five years.

Note: No funds have been allocated for the borrower pay-for-performance success incentive as the required 12 months have not yet transpired since the first trial period started.

Source: Treasury, Home Affordable Modification Program Guidelines, March 4, 2009.

### *Complementary Programs*

HAMP’s first lien program, described above, is just one of the programs under the broader MHA efforts designed to assist struggling homeowners. Some of the other programs are designed to

work in conjunction with HAMP; others are intended to provide alternative forms of relief to homeowners. These other programs are as follows:

- The Home Affordable Refinance Program is intended to provide access to low-cost refinancing for homeowners suffering from falling home prices and whose mortgages are owned or backed by Fannie Mae or Freddie Mac. Treasury does not administer the Home Affordable Refinance Program; the government-sponsored enterprises (“GSE”) administer the Home Affordable Refinance Program themselves, under the supervision of their regulator and conservator, the Federal Housing Finance Agency.
- The Second Lien Modification Program includes homeowner relief for those facing default or foreclosure with second mortgages. The program is intended to work within the framework of HAMP to offer a more complete relief package for homeowners with second liens. A homeowner cannot qualify for the Second Lien Modification Program unless his or her first loan has been modified under HAMP.
- The Home Price Decline Protection Incentives are intended to encourage additional investor participation and HAMP modifications in areas with recent price declines by providing additional payments to investors in areas that have suffered a decline in home prices.
- The Home Affordable Foreclosure Alternatives are intended to enable servicers and borrowers to pursue short sales and deeds-in-lieu of foreclosure for HAMP-eligible borrowers in cases where the borrower is unable or unwilling to modify his or her mortgage.

For more detailed descriptions of these programs, see SIGTARP’s July 2009 Quarterly Report to Congress, pages 114-116; October 2009 Quarterly Report to Congress, page 97; and January 2010 Quarterly Report to Congress, page 98.

# The Number of Permanent Modifications Entered Into During HAMP's First Year Has Been Below Expectations

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*This section addresses what Treasury's participation goals for HAMP are and examines whether those goals have been met during the program's first year. The next section will examine the challenges that have confronted and continue to confront Treasury in implementing HAMP.*

Treasury states that its goal for HAMP is that the program will *offer* trial modifications to 3 to 4 million borrowers at risk from its inception through its expiration at the end of 2012. This section first examines how Treasury has articulated its goals for HAMP and notes that Treasury's initial statements about the program indicated that HAMP was originally intended to result in 3 to 4 million permanent modifications — a level that simply will not be met absent an unanticipated and dramatic increase in participation. Irrespective of how the goal is defined, although Treasury has made progress in developing the administrative backbone of the program and in getting the program started rapidly — meeting targets for servicer participation and a goal for early trial modifications — the rate of permanent modifications thus far has been slow. From HAMP's inception through February 2010, only 168,708 mortgages have been permanently modified.<sup>6</sup>

## Treasury's HAMP Participation Goal

In its discussions with SIGTARP during the course of this audit, Treasury has insisted that its participation goal for HAMP is — and has been from the program's inception — that 3 to 4 million borrowers will be *offered* trial mortgage modifications over the four years of the program. In other words, Treasury's stated goal is not tied to how many borrowers are actually helped by entering permanent modifications, but rather how many had the opportunity to enter trial modifications by receiving offers.

What the anticipated benefits of a program are and how a program's success or failure is defined are important to provide a reference point for discussions about whether a program is worth the resources devoted to it and whether the program is functioning as it should. An examination of how Treasury has articulated its HAMP participation goal over time demonstrates that Treasury has been less than consistent about how it has justified the program's costs or defined what

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<sup>6</sup> Treasury reports 1,499 of the 170,207 permanent modifications started have been cancelled, resulting in 168,708 active permanent modifications as of February 2010.

success in the program would mean. Many of Treasury's prior statements about the program have strongly suggested that HAMP would result in 3 to 4 million permanent modifications, not merely offers for trial modifications. For example:

- When the outlines of MHA and HAMP were developed in early 2009 by a working group of officials from Treasury, the Department of Housing and Urban Development (“HUD”) and the White House, they advocated that the refinance and modification programs should “have a scale that can have a real impact on turning the housing problems around in this country.”
- When HAMP was announced in February 2009, the Administration announced that the program's goal was to “enable as many as 3 to 4 million homeowners to modify the terms of their mortgage to avoid foreclosure.”
- In a summary sheet describing HAMP guidelines released on March 4, 2009, Treasury stated that HAMP “will help up to 3 to 4 million at-risk homeowners avoid foreclosure by reducing monthly mortgage payments.”
- In its first supplemental directive concerning program guidelines, dated April 6, 2009, Treasury described HAMP as a “national modification program aimed at helping 3 to 4 million at-risk homeowners — both those who are in default and those who are at imminent risk of default — by reducing monthly payments to sustainable levels.”
- Treasury's Web site still states that HAMP was created as “a \$75 billion loan modification program to help up to 4 million families avoid foreclosure.”

In sum, Treasury has repeatedly given the distinct impression that HAMP will help 3 to 4 million homeowners actually avoid foreclosure by reducing their monthly mortgage payments to a level that they can afford over the long term; those positive results can only occur with permanent modifications. Although Treasury has, at times, noted that the goal was tied to offers and not actual modifications,<sup>7</sup> in its discussions with SIGTARP in connection with this audit, Treasury has conceded that its use of language in describing HAMP's participation goals has been “confusing” and that it has not been “crisp” in defining its goals. Although SIGTARP is skeptical, as discussed below, about whether Treasury's goal of giving *offers* for trial modifications is a meaningful one, for purposes of this discussion at least, SIGTARP accepts Treasury's assertion that its goal has always been offers and not permanent modifications.

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<sup>7</sup> In a March 4, 2009 MHA program description, Treasury stated that they were “creating a comprehensive stability initiative to offer reduced monthly payments for up to 3 to 4 million at-risk homeowners...” In testimony on July 24, 2009, before the House Financial Services Committee, Treasury Secretary Geithner stated that “3 to 4 million homeowners will be offered trial loan modifications under the Administration's program.” In testimony before the Congressional Oversight Panel on September 10, 2009, Treasury Secretary Geithner stated that HAMP was “designed to allow 3 to 4 million families the chance to stay in their homes.” The MHA Monthly Program Report, for October 2009 and each month thereafter, has stated that HAMP has a “goal of offering 3 to 4 million homeowners lower mortgage payments through a modification over three years.”

In any event, during the course of this audit, a Treasury official estimated that under HAMP a total of approximately 3 million trial modifications will be initiated and between 1.5 and 2 million of those will become permanent modifications.

## Status of Participation in HAMP

Treasury has made substantial progress during the year since the announcement of HAMP in attaining servicer participation. HAMP goals were developed based on a projection that servicer participation would be 90 percent as measured by coverage of all privately-owned mortgages. In its first publicly available monthly HAMP status report, which covered activity through July 2009, Treasury reported that 38 servicers had signed agreements to modify mortgages, with those servicers covering approximately 85 percent of eligible mortgage debt outstanding. By January 2010, 110 servicers of privately-owned mortgages were participating in HAMP, with approximately 89 percent of all potentially eligible mortgage debt outstanding covered by those servicers. Servicer participation levels, therefore, are very close to projected levels.

The program's experience of attaining borrower participation, however, has been mixed. The first batch of servicers entered into agreements enabling them to start trial modifications in April 2009. Through July, Treasury reported there were 235,247 trial modifications, but Treasury recognized that much more had to be done to help homeowners. In July, Treasury and HUD took steps to accelerate this pace. On July 9, 2009, Treasury Secretary Geithner and HUD Secretary Shaun Donovan wrote the Chief Executive Officers of participating servicers calling upon them to redouble their efforts to increase staffing and improve borrower response times. On July 28, 2009, Treasury, HUD and other government officials met with senior officials from servicers participating in HAMP to discuss ways in which to accelerate the program. At that meeting, three steps were announced to improve the program's performance: (a) performance on a servicer-by-servicer basis would be publicly reported, (b) performance metrics would be developed, and (c) Freddie Mac, in its role as the program's compliance agent, would take a "second-look" at a sample population of modifications. At that time, it was also announced that the Administration had instituted a goal to reach 500,000 trial modifications by November 1, 2009.

The goal of 500,000 trial modifications was met by early October; indeed, Treasury reported a total of nearly 700,000 trial modifications by November 1, 2009. At the same time, however, Treasury had not disclosed the number of permanent modifications in its monthly Servicer Performance Report through November 1, 2009. The slow pace of conversions from trial to permanent modifications prompted Treasury and HUD, in November 2009, to undertake a "conversion drive." According to public statements by Treasury, through that point, servicers had "not done a good enough job of bringing people a permanent modification solution" and needed "to do better."<sup>8</sup> One Treasury official told the press that "some of the firms ought to be embarrassed, and they will be." The conversion drive included:

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<sup>8</sup> For their part, servicers stated that a lack of guidance from Treasury and constantly changing program guidelines were challenges to implementing HAMP. These issues are discussed in more detail in the next section.

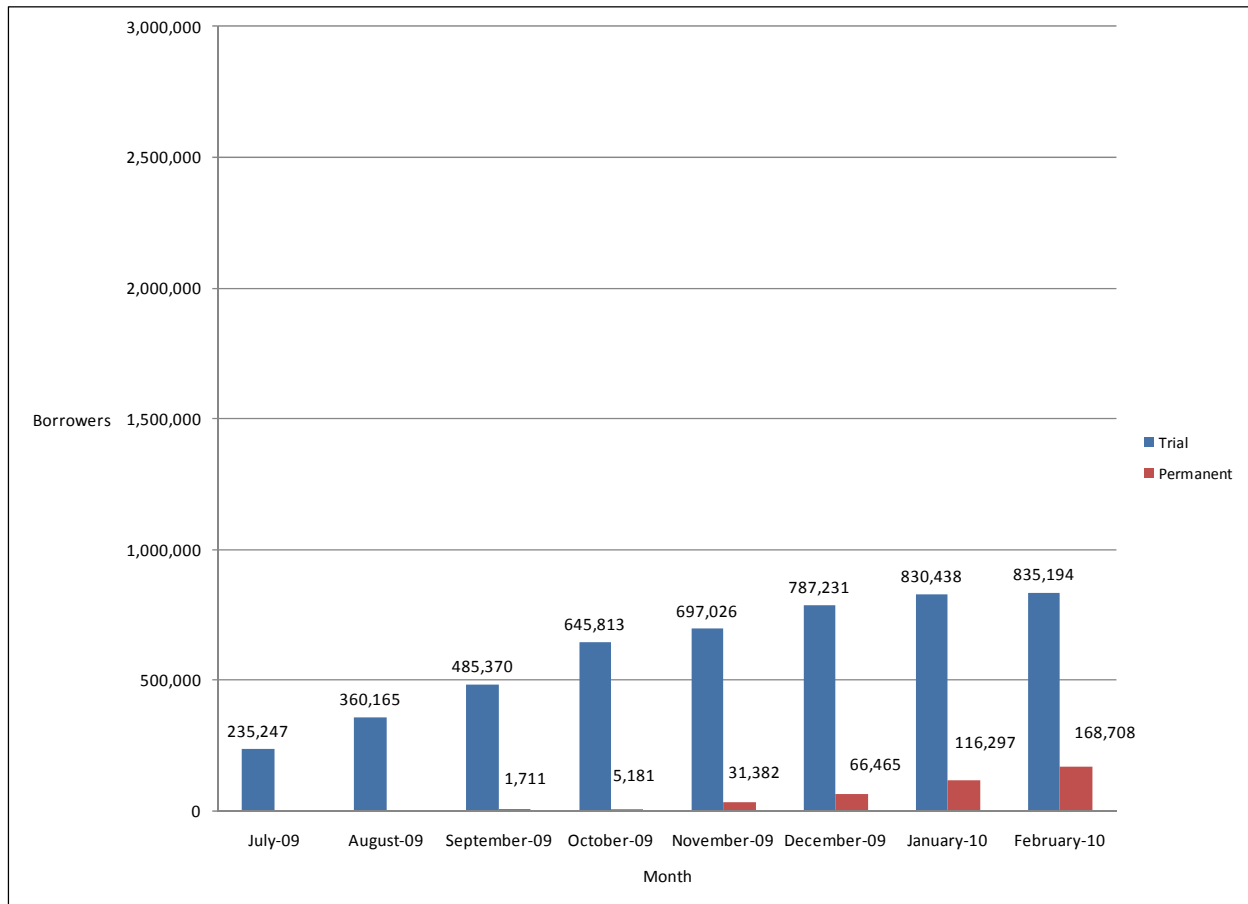


- public reporting of conversion rates by servicer
- regular communications with the servicers and reporting by the servicers on conversions
- the deployment of conversion “SWAT” teams to assist the largest servicers
- engagement with key state and local groups in an outreach campaign

During the conversion drive, Treasury identified approximately 375,000 of the nearly 700,000 borrowers in modifications were eligible to convert to permanent modifications by December 31, 2009. According to the Chief Homeownership Preservation Officer, of this group of borrowers, approximately one-third was simply awaiting a decision from their servicers as to whether they qualified for a permanent modification; about 37 percent had submitted some, but not all, documents necessary; and more than 20 percent had submitted no documents at all to their servicers.

Approximately 31,000 mortgages were moved into permanent modifications through November 2009; the total number of permanent modifications was approximately 66,000 through December (a monthly increase of 35,000) and 116,000 through January 2010 (a monthly increase of 50,000). In total, through February 2010, approximately 1,000,000 cumulative mortgages were actively in HAMP modifications (168,708 cumulative active permanent modifications and 835,194 cumulative active trial modifications). Figure 1 shows the number of cumulative trial and permanent modifications completed through each month from July 2009 through February 2010.

**Figure 1—Growth in Active Modifications (Cumulative Data from July 2009 through February 2010)**



Notes: The permanent modification number for September includes all active permanent modification from program inception. Treasury reports 1,499 of the 170,207 permanent modifications started have been cancelled, resulting in 168,708 active permanent modifications as of February 2010.

Source: Treasury, Making Home Affordable Servicer Performance Reports, July 2009 through January 2010.

## The Pace of Modifications Has Not Met Expectations Thus Far

Conversions from trial modifications to permanent modifications have been slow thus far: only 15 percent or 168,708 mortgages of the total 1,094,064 trial modifications started are still in active permanent status. Monthly conversions to permanent status from October through February have been 3,000; 26,000; 35,000; 50,000; and 52,000.<sup>9</sup> Unfortunately, a Treasury official has indicated that even this modest pace of permanent modifications will not be sustainable and that the number of cancellations will likely increase.

<sup>9</sup> There were nearly 2,000 conversions to permanent modification from the beginning of the program through the end of September 2009.

Treasury faces two significant hurdles in converting the current substantial backlog of trial modifications into permanent status. The first relates to verbal modifications. On or prior to April 15, 2010, servicers are permitted to start a borrower's trial modification with stated income, or verbal financial information, which is inherently less reliable than documented information. As of December 21, 2009, Treasury reported 18 HAMP servicers, including four of the five largest HAMP servicers, had used stated income when determining initial HAMP eligibility. This documentation is required to be collected before the trial modification ends. One of the servicers SIGTARP visited expressed concern for the resulting "disproportionate time and expense" required to narrow down those homeowners who will actually transition to a final modification among those who received verbal trial modifications. Identifying and removing from the program ineligible borrowers who already started trial modifications as a result of inaccurate, verbal income information is an additional strain on a servicer's already limited resources. Although use of verbal financial information certainly helped Treasury meet its interim target of achieving 500,000 trial modifications by November 2009; because of this diversion of resources, allowing verbal modifications was arguably counterproductive to attaining permanent modifications.<sup>10</sup> Treasury has since recognized the limits of relying on unverified financial information before commencing trial modifications and issued a policy on January 28, 2010, ending this practice for all trial periods initiated after April 15, 2010. Although this tightening of the standards makes sense, it presumably will reduce the already declining number of trial modifications coming into the system, providing further reason to question whether the flow of trial modifications into the system is sufficient, as discussed below.

The second issue affecting conversion relates to when payments are due during the trial period. On or prior to April 15, 2010, after the borrower makes the first trial modification payment during the initial month in which the trial modification becomes effective, he or she has the full length of the trial period to satisfy further trial payment requirements. The borrower can thus make the remaining two payments (or three payments for borrowers at imminent risk of defaulting)<sup>11</sup> on the last day of the final trial period month. As such, a borrower's likelihood for default is concealed during the trial period and borrowers may have an incentive to delay entering into permanent modifications. About 25 percent of homeowners who received trial loan modifications and were targeted for the conversion campaign failed to keep up with their new reduced payments, and at least 93,750 borrowers have missed required payments. Accordingly, the backlog of trial modifications may be heavily populated by homeowners who are unable or unwilling to make the required trial modification payments but who have been able to forestall foreclosure (and live effectively rent free) during the term of the trial modification. Several of the servicers interviewed reported concerns about homeowners trying to game the system in this fashion. Treasury changed these payment requirements so that after April 15, 2010, a borrower must make monthly payments to be considered current.

In addition to potential problems in converting the backlog of trial modifications to permanent modifications, recent data suggests that it might prove to be difficult to bring sufficient new trial

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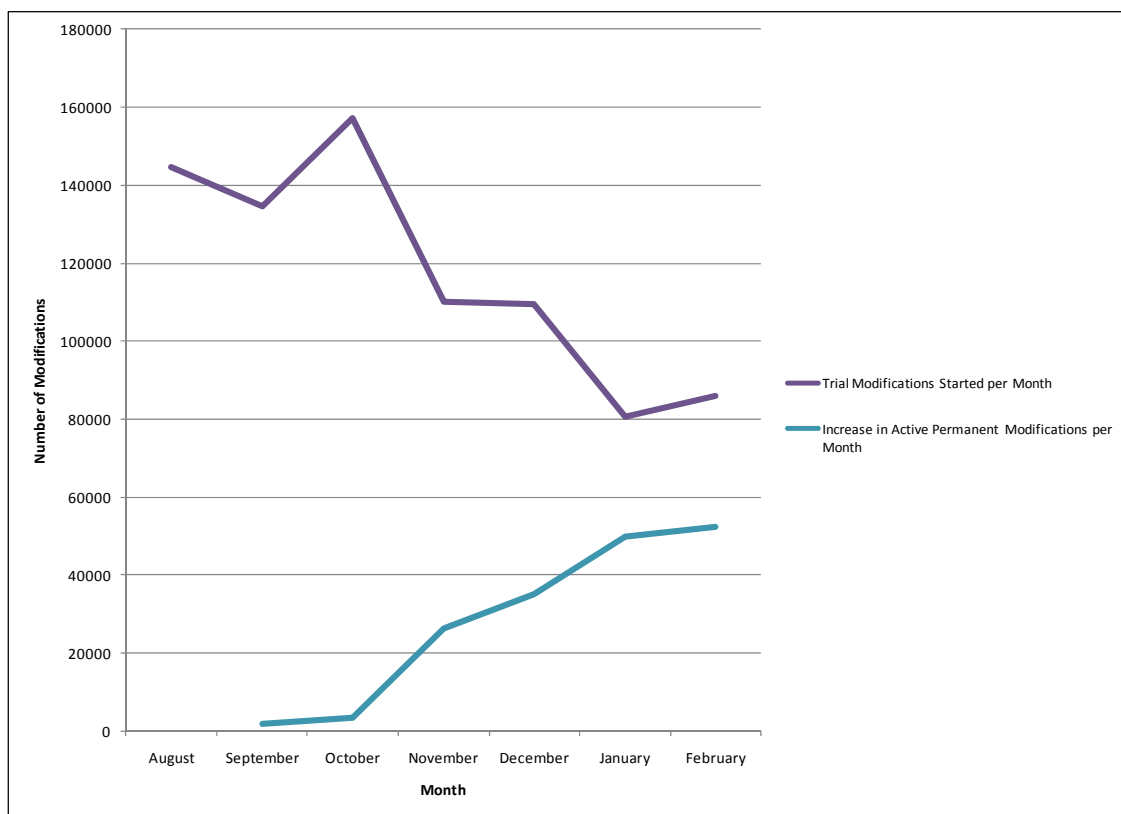
<sup>10</sup> In providing recommendations on HAMP program design, SIGTARP warned against such reliance on unverified information. See SIGTARP's Quarterly Report to Congress dated October 21, 2009, beginning on page 158.

<sup>11</sup> Non-defaulted borrowers facing a financial hardship are considered at imminent risk of defaulting. This category of borrowers has a four-month HAMP trial period.

modifications into the program. Since October, new trial modifications have only averaged about 96,000 per month (approximately 110,000 in November; 110,000 in December; 80,000 in January; and 85,000 in February). It is clear, however, that a certain percentage of homeowners who enter trial modifications will fall out of the program before successfully entering a permanent modification due to, for example, re-default during the trial period. A Treasury official estimated that 50 percent to 66 percent of trial modifications will become permanent,<sup>12</sup> and indeed, the Assistant Secretary for Financial Stability has testified before the Congressional Oversight Panel that past experience would suggest that a 50 percent conversion rate would be the minimum expected and that a 75 percent conversion rate would make it “quite a successful program.”

Figure 2 shows monthly borrower participation in both trial and permanent modifications since August 2009.

**Figure 2—Modifications Started Per Month (Non-Cumulative Data for August 2009 through February 2010)**



Note: Treasury issued its first publicly-available monthly HAMP status report — Making Home Affordable Servicer Performance Report — in August 2009.

Source: Treasury, Making Home Affordable Servicer Performance Reports, July 2009 through February 2010.

<sup>12</sup> During the audit, a Treasury official estimated that there will be a total of 3 million trial modifications, of which 1.5 to 2 million will convert to permanent modification status.

## Other Factors That Could Impede HAMP's Long-Term Success

Before discussing HAMP implementation issues in more detail, other factors that could impede HAMP's long-term success, irrespective of whether Treasury's articulation of its intended goals, should be noted. These issues are discussed briefly below.

- **Re-defaults** – In the modeling it conducted in connection with HAMP, Treasury used a 40 percent re-default rate. In other words, Treasury has estimated that, for every 10 mortgages that enter into HAMP modifications (trial and permanent), four of those homeowners will re-default and potentially be in danger of losing their homes to foreclosure over the five years of the modifications.<sup>13</sup> It is still too early to determine the impact of re-defaults on the program's success or whether Treasury's estimates are accurate, and SIGTARP will continue to monitor this critically important issue.
- **Limitations on debt-to-income eligibility ratio** – HAMP uses an affordability ratio that excludes other factors that would normally be accounted for in traditional loan underwriting, thereby potentially overestimating the true ability of the borrowers to repay, which in turn will impact their ability to make modified payments in either a trial or a permanent modification. HAMP servicers use a monthly “front-end” debt-to-income eligibility ratio of 31 percent, consistent with a Federal Housing Administration underwriting guideline. In using this front-end calculation, the only debt HAMP servicers consider is mortgage debt<sup>14</sup> — the borrower's other debts (*e.g.*, car payments, student loans, credit card obligations, and second liens on the home) are not factored into the front-end debt-to-income calculation. Although the Federal Housing Administration uses a 31 percent front-end debt-to-income ratio when underwriting mortgages, it also requires lenders to consider the total debt-to-income ratio when determining whether a borrower qualifies for a mortgage. Both ratios must be below a designated threshold in order for the borrower to demonstrate his or her ability to make timely mortgage payments. In contrast, although HAMP servicers are required to calculate the borrower's total debt-to-income ratio, high total ratios will not exclude borrowers from participating in HAMP. Instead, borrowers with total debt-to-income ratios greater than or equal to 55 percent must simply sign a statement that they will work with an HUD-approved counselor. As a result, many HAMP participants have their monthly mortgage debt reduced but still have a debt-to-income ratio that may be far too high for them to be able to afford to continue to make monthly mortgage payments, even at the HAMP-reduced amounts, thereby increasing their likelihood to re-default. As of December 2009, borrowers with total debt-to-income ratios greater than 50 percent represented more than half of HAMP permanent modifications. Thirty-two percent of all borrowers holding HAMP permanent modifications had total debt-to-income ratios greater than 70 percent. This problem is exacerbated, of course, by the unacceptably high unemployment rates,

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<sup>13</sup> When a borrower re-defaults during a trial modification, he is still responsible for the difference between the original payments and the modified payments made during the trial modification period.

<sup>14</sup> Mortgage debt is defined as principal, interest, taxes, insurance, and homeowners'/condominium association fees for HAMP purposes. This excludes second lien mortgage debt.

which will potentially increase household debt and could have a dramatic impact on re-default rates.

- **Five-year period of permanent modifications** – HAMP’s permanent modification is designed to last for five years. Treasury based the five year period on “analysis used to determine a reasonable time frame for price recovery, including review of future prices, a statistical analysis of the steepness of actual price declines, consideration of broader macroeconomic forecasts, experiences of other modification programs, and judgment.” Unlike a traditional fixed-rate mortgage, if the interest rate on a HAMP modification is adjusted to below prevailing market rates, after the five-year fixed period, the rate can incrementally increase by up to one percent per year, capped at the 30-year conforming fixed rate<sup>15</sup> on the day the modification agreement is drafted. Borrowers, however, may be unable to meet the increasing monthly payments once the interest rate begins to increase if the borrower’s income has not increased commensurate with the interest rate adjustments, a situation that led to widespread defaults for sub-prime adjustable rate mortgages during the current financial crisis. Using the HAMP average unpaid principal balance of \$247,149 (as of November 2009) and average remaining term of 327 months, a borrower with a two percent modification interest rate will face a monthly payment that is 23 percent higher in the fourth year after the permanent modification period if the rate is incrementally increased by one percentage point annually. However, current projections suggest that salaries may not increase by a corresponding rate.
- **Second liens** – Treasury has estimated that up to 50 percent of mortgages at risk of delinquency and foreclosure are backed by second liens. Although borrowers may receive a HAMP permanent modification on their first lien, the total monthly mortgage payment might still be unaffordable if the second lien is not modified or extinguished. Under the second lien program, when a borrower’s first lien is modified under HAMP and the servicer of the second lien is a HAMP participant,<sup>16</sup> that servicer must offer either to modify the borrower’s second lien according to a defined protocol or to accept a lump sum payment from Treasury in exchange for full extinguishment of the second lien. The second lien program follows a standard waterfall similar to HAMP’s first lien program. Servicers can begin immediately to modify or extinguish loans under the second lien program, once they sign Servicer Participation Agreements to participate in the program. The second lien program has not been fully implemented, although it was announced in April 2009 and designed to work in tandem with HAMP. Participation to date has been extremely limited, but with the recent signing of Bank of America, Wells Fargo, and JPMorgan Chase, it is improving.

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<sup>15</sup> This rate represents the fixed interest rate on a 30-year loan that has a principal balance less than the maximum principal amount of mortgage which Fannie Mae and Freddie Mac can purchase, sell, and securitize. For example, a mortgage that was modified on January 7, 2010, would be capped at 5.09 percent.

<sup>16</sup> A servicer must execute a Servicer Participation Agreement or amend and restate an existing Servicer Participation Agreement previously executed for HAMP to participate in the HAMP Second Lien Modification Program.



- **Negative equity and strategic defaults** – Negative equity results when more is owed on a property than the property is worth. HAMP does not require servicers to address negative equity,<sup>17</sup> which an industry expert has called the “most important predictor of default.” It is estimated that homeowners who have negative equity (currently constituting about 25 percent of all borrowers nationwide) represent almost half of all foreclosures. During the course of our audit work, SIGTARP was not able to obtain documentation to support the different estimates as to the weighted average of the combined mortgage loan amounts<sup>18</sup> compared to the home’s value for all borrowers in HAMP trial modifications, but the numbers all indicate that the average HAMP mortgage is underwater. For example, Fannie Mae reported to SIGTARP that the ratio was 247 percent through November 2009, which Treasury has “corrected” to 140 percent. Treasury currently estimates that the ratio is 114 percent.
  - The primary method of quickly addressing negative equity is through principal reductions. However, Treasury Secretary Geithner testified during the December 10, 2009 Congressional Oversight Panel hearing that Treasury made a “conscious choice . . . not to start [HAMP] with principal reductions.” He stated it was determined that principal reductions were “more expensive for taxpayers,” “harder to justify,” and had a higher “risk of unfairness.” Principal reduction is a long-term means of making payments affordable, but can pose moral hazard.<sup>19</sup> In this context, borrowers who are current on their mortgages may consciously choose to stop paying their mortgage if they are aware that delinquent borrowers receive incentives and financial assistance under HAMP.
  - The practice of a borrower choosing to default on the mortgage, even when he or she can afford the payments, is called strategic default. Strategic default usually occurs when the home’s value is substantially lower than the mortgage value. Although relatively common in commercial real estate, it has been widely reported that homeowners may be increasingly more likely to strategically default on their homes. Given the amount of negative equity in the mortgages under trial modifications, strategic default may become a factor in HAMP re-defaults, as borrowers decide that it makes more economic sense for them to walk away from

<sup>17</sup> HAMP allows principal reduction, but it is not typically implemented in practice. Servicers forgave principal on less than two percent of HAMP trial loans. Before HAMP, 10 percent of servicer-sponsored modifications forgave principal. Rather than forgiving principal, HAMP primarily reduces monthly payments through interest rate reductions, amortization term extensions, and principal forbearance. On February 19, 2010, however, the Administration announced a new initiative to help the housing markets that have experienced 20 percent or more average home price decreases. The program allocates \$1.5 billion of TARP funds for a limited number of states’ housing finance agencies to address housing priorities in the local markets. The state agencies will submit proposals to Treasury for approval before Treasury funds the programs. The proposals may include measures for unemployed homeowners, assistance to borrowers owing more than their home is now worth, help to address challenges arising from second mortgages, or other programs encouraging sustainable and affordable homeownership. Until the states submit proposals, it is unclear whether any or all of the programs will include the items discussed above.

<sup>18</sup> Combined loan-to-value ratio compares the value of all outstanding mortgages on the home to the home’s value.

<sup>19</sup> Moral hazard occurs when someone insulated against a risk (such as in the context of a government bailout program) may behave differently than if they bore the full risk.

their mortgages, and rent at a lower cost, rather than continue to make higher payments that may never result in them obtaining equity in their mortgage.

# Several Issues Relating to HAMP Implementation Have Posed Challenges to HAMP Participation, in Particular to Converting Trial Modifications into Permanent Modifications

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*This section describes how Treasury has implemented HAMP and some of the program challenges that have been encountered.*

When HAMP was announced in February 2009, Treasury committed to implement the program rapidly, with Treasury Secretary Geithner stating that HAMP would work at an “extraordinarily rapid pace for a program.” As promised, the program was rolled out quickly, with initial program guidelines released in March 2009 and the first agreements with servicers being executed in April. In July, Treasury also placed pressure on servicers to move more quickly and instituted a goal of 500,000 trial modifications by November. Although that goal was met, by November it became clear that the pace of conversions from trial modifications to permanent modifications was slower than expected, and Treasury’s Assistant Secretary for Financial Stability stated that the department was “disappointed in the permanent modification results thus far.” Treasury has blamed servicers for this disappointing result; servicers have blamed Treasury’s implementation; and both have blamed homeowners for failing to comply with documentation requirements.

## Steps Treasury Took to Implement HAMP

Treasury attempted to get HAMP running rapidly. President Obama announced the Homeowner Affordability and Stability Plan, of which HAMP was a major component, on February 18, 2009. Fourteen days later, the Administration and Treasury released what they called “detailed requirements” that they indicated would equip servicers with the information necessary to begin modifying mortgages. Fifteen days after that, Treasury launched the Making Home Affordable Web site, an online resource intended to educate borrowers about HAMP. On April 6, 2009, Treasury issued its first supplemental directive containing additional guidance to servicers for implementation of HAMP for privately-owned mortgages. One week later, on April 13, 2009,

the first six servicers signed servicer participation agreements, making them eligible to modify loans under HAMP.<sup>20</sup>

In July, Treasury took a series of steps to accelerate the pace of HAMP participation.

- On July 9, 2009, Treasury Secretary Geithner and HUD Secretary Donovan wrote the Chief Executive Officers of participating servicers calling upon them to redouble their efforts to increase staffing, improve borrower response times and streamline the application process.
- On July 28, 2009, Treasury, HUD and other government officials met with senior officials from servicers participating in HAMP to discuss ways in which to accelerate the program and bring relief to homeowners faster. At that meeting, steps were announced to improve the program's performance, including reporting on performance on a servicer-by-servicer basis, the development of performance metrics, and that Freddie Mac, in its role as the program's compliance agent, would take a "second-look" at a sample of modifications.
- The Administration announced a goal to reach 500,000 trial modifications by November 1, 2009.

The goal of 500,000 trial modifications was met by early October. By then, however, it was becoming clear that the rate of conversion from trial modifications to permanent modifications was very slow. Through the end of October, there were more than 650,000 active trial modifications, but Treasury had not disclosed the number of permanent modifications in its monthly Servicer Performance Report through November 1, 2009.

The slow pace of conversions from trial modifications to permanent modifications prompted Treasury and HUD to undertake a "conversion drive" in November 2009. According to public statements by Treasury, servicers had, up to that point, "not done a good enough job of bringing people a permanent modification solution" and needed "to do better."<sup>21</sup> The conversion drive included similar measures as in the earlier drive to increase trial modifications, including putting pressure on the servicers by making results public. The initial announcement included:

- publicly reporting conversion rates by servicer
- regular communications with the servicers and reporting by the servicers on conversions
- the deployment of conversion "SWAT" teams to assist the largest servicers

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<sup>20</sup> Beginning in April and May of 2009, Treasury attempted to expand homeowner relief and increase modification affordability programs that were complementary to HAMP or that provided alternative relief, announcing the Second Lien Modification Program, foreclosure alternatives such as deed-in-lieu and short sale, and the Home Price Decline Protection Incentive. It took Treasury another three months until it announced program details, however, and another five months after that until the first servicer signed a contract to participate in the Second Lien Modification Program in late January 2010.

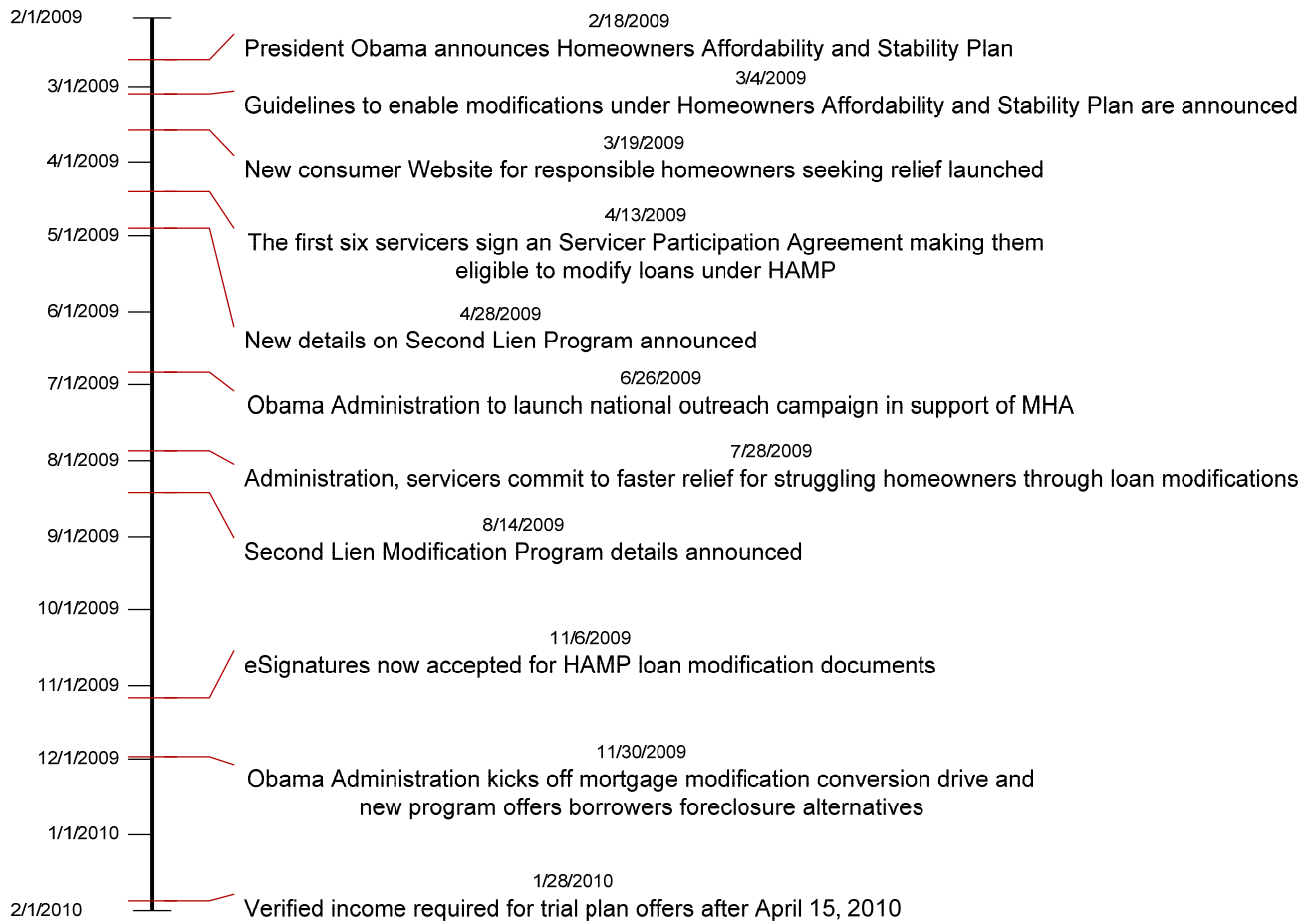
<sup>21</sup> For their part, servicers stated that a lack of guidance from Treasury and constantly changing program guidelines were challenges to implementing HAMP.

- engagement with key state and local groups in an outreach campaign

On January 28, 2010, Treasury announced that it would require servicers to obtain verifiable income documentation prior to trial modification, beginning with borrowers entering trial modifications after April 15, 2010.

Figure 3 is a timeline of several key HAMP implementation milestones from the announcement of the program through February 2010.

**Figure 3—Key HAMP Implementation Milestones (February 18, 2009 through February 2010)**



Source: SIGTARP analysis of Treasury Press Releases and Supplemental Directives.

## Difficulties Encountered in Implementing HAMP

Although the reasons for the disappointing results thus far are many, discussions with Treasury, the GSEs, and the servicers, and an analysis of performance data have identified several specific issues concerning HAMP implementation that have posed particular challenges.

### *Changing Documentation Requirements*

Receiving required documentation from borrowers has been a significant challenge in moving trial modifications into permanent status. Treasury has identified this as a significant challenge, and servicers have reported difficulties in obtaining borrowers' income documentation. These views have been borne out by the data. Of the 375,000 trial modifications targeted for conversion in November, a majority had incomplete documentation and 20 percent had supplied no documentation at all.

Treasury has changed the standards for what documents are required and whether trial modifications can be entered into before such documentation is provided since the program was rolled out. Table 4 tracks the changes in what documents have been required for borrowers to verify income.

**Table 4—Changes in HAMP Income Documentation Requirements**

Date	Change Description	Documentation Requirements and Changes
<b>3/4/2009</b>	Treasury's initial program guidelines stated that a servicer may accept either documented or verbal income from the borrower to determine whether a borrower is eligible for a trial modification.	<ul style="list-style-type: none"> <li>• Signed Form 4506-T</li> <li>• Two most recent paystubs for wage earners, and other third party document of reasonable reliability for self-employed</li> <li>• Representation that the borrower does not have sufficient liquid assets to make monthly payments</li> <li>• Obtaining most recent tax return on file</li> </ul>
<b>4/6/2009</b>	Supplemental Directive 09-01 provided additional detail as to what kinds of documentation would be deemed sufficient before conversion to a permanent modification.	<p>If borrower is employed:</p> <ul style="list-style-type: none"> <li>• A signed copy of most recently filed federal tax return</li> <li>• A signed Form 4506-T</li> <li>• Copies of two most recent paystubs indicating year-to-date earnings</li> <li>• A letter from a reliable third party for all bonuses, commissions, fees, housing allowances, tips and overtime.</li> </ul> <p>If self-employed:</p> <ul style="list-style-type: none"> <li>• A signed copy of most recently filed federal tax return</li> <li>• A signed Form 4506-T</li> <li>• Most recent quarterly year-to-date profit/loss statement</li> <li>• Other third party reliable documentation voluntarily provided</li> </ul> <p>If borrower uses alimony or child support:</p> <ul style="list-style-type: none"> <li>• Photocopy of divorce decree or other legal written assignment providing for payment of alimony, and documentation of payment. Servicers must determine that income will continue for three years.</li> </ul> <p>If borrower uses benefit income (such as social security):</p>



		<ul style="list-style-type: none"> <li>Documentation showing amount of benefit, frequency and duration (must continue for three years).</li> <li>Must obtain copies of signed federal tax returns, W-2 forms or copies of two most recent bank statements.</li> </ul> <p>If borrower receives public assistance or unemployment:</p> <ul style="list-style-type: none"> <li>Documentation showing amount, frequency and duration. Servicers must determine the income will continue for nine months.</li> </ul> <p>If borrower uses Rental income:</p> <ul style="list-style-type: none"> <li>Signed Federal income tax returns including Schedule E, supplemental income and loss. This income will be counted at 75 percent.</li> </ul>
<b>7/6/2009</b>	Treasury's Supplemental Directive 09-03 announced that the servicer should begin trial modification period reporting once the servicer receives the borrower's first trial period payment regardless of whether the servicer has received an executed copy of the trial period plan.	Same documentation requirements as Supplemental Directive 09-01, but <i>borrower may be put into trial period without the executed copy of the trial period plan.</i>
<b>10/8/2009</b>	Treasury's Supplemental Directive 09-07 represents an ongoing effort to improve process efficiency by updating the borrower underwriting requirements by permitting "alternative" forms of income verification before conversion to a permanent modification and introducing revised model documentation for the program.	<p>Servicers can still put a borrower into a trial period with stated income, but the income documentation collection now includes:</p> <ul style="list-style-type: none"> <li>Signed Form 4506-T</li> <li>Those in imminent default may, in accordance with investor guidelines, be required to provide the most recent signed copy of their federal income taxes. All other borrowers may, but are not required to submit.</li> <li>Copies of two most recent paystubs with year-to-date earnings</li> </ul> <p>If self-employed:</p> <ul style="list-style-type: none"> <li>The most recent quarterly or year-to-date profit and loss statement</li> </ul> <p>If borrower earns "other" income:</p> <ul style="list-style-type: none"> <li>Reliable third party documentation describing nature of income</li> </ul> <p>If borrower uses alimony, separation maintenance, or child support income:</p> <ul style="list-style-type: none"> <li>Copy of divorce decree, or other legal written assignment providing for payment of alimony or child support and duration of payment.</li> <li>Evidence of receipt of payment, such as bank statements with amount of payment</li> </ul> <p>If borrower receives public assistance or unemployment:</p> <ul style="list-style-type: none"> <li>Evidence of amount, frequency and duration of the benefits, which must continue for nine months.</li> </ul> <p>If borrower uses rental income:</p> <ul style="list-style-type: none"> <li>Signed Federal income tax returns including Schedule E, supplemental income and loss. This income will be counted at 75 percent.</li> </ul> <p>If borrower uses benefit income (such as social security):</p> <ul style="list-style-type: none"> <li>Evidence of amount and frequency of benefit</li> <li>Evidence of receipt of payment</li> </ul> <p>All passive and non-wage income (including rental, part-time employment, bonus/tip, investment and benefit income) does not have to be documented if borrower declares the income and it constitutes less than 20 percent of total income.</p>
<b>1/28/2010</b>	Treasury's Supplemental Directive 10-01 requires full verification of borrower eligibility after April 15, 2010, including documented	<p>A servicer may only evaluate a borrower for HAMP after it receives: Request for Modification and Affidavit Form, Form 4506-T or 4506T-EZ and evidence of income, including:</p> <ul style="list-style-type: none"> <li>Copies of two recent paystubs which do not have to be</li> </ul>

	<p>verification of income, prior to offering a trial period plan.</p>	<p>consecutive.</p> <ul style="list-style-type: none"> <li>• The most recent quarterly or year-to-date profit and loss statement for self employed</li> <li>• Reliable third party documentation describing nature of income for all bonuses, commissions, fees, housing allowances, tips and overtime.</li> </ul> <p>If borrower earns benefit income (such as social security):</p> <ul style="list-style-type: none"> <li>• Evidence of amount and frequency of benefit</li> <li>• Receipt of payment, such as bank statements showing deposit amounts.</li> </ul> <p>If borrower receives unemployment:</p> <ul style="list-style-type: none"> <li>• Evidence of amount, frequency and duration of the benefits, which must continue for nine months.</li> </ul> <p>If borrower uses Rental income:</p> <ul style="list-style-type: none"> <li>• Signed Federal income tax returns which include Schedule E, supplemental income and loss. This income will be counted at 75 percent.</li> </ul> <p>If borrower uses alimony, separation maintenance, and child support income:</p> <ul style="list-style-type: none"> <li>• Copy of divorce decree, or other legal written assignment providing for payment of alimony or child support and duration of payment.</li> <li>• Evidence of receipt of payment, such as bank statements with amount of payment</li> </ul> <p>All passive and non-wage income (including rental, part-time employment, bonus/tip, investment and benefit income) does not have to be documented if borrower declares income and it constitutes less than 20 percent of total income.</p> <p>Non-borrower income voluntarily provided may be included if the servicer decides the income can be relied upon to continue. The directive permits servicers to substitute their "business judgment" in determining the forms of verification necessary to convert a trial modification to permanent status.</p>
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Source: SIGTARP analysis of Treasury program guidelines.

All five of the servicers interviewed in connection with this audit have identified problems of one sort or another that they have experienced due to repeated changes in program guidelines. One servicer in particular noted that it changed from offering only fully documented trial modifications to verbal modifications after Treasury threatened to make examples of servicers with low trial modification numbers.<sup>22</sup> Servicers have reported, among other things, that:

- repeated changes to program guidelines have made it difficult for servicers' operators to keep up with program rules;
- verbal modifications have allowed borrowers to obtain trial modifications due to misrepresentations, and identifying borrowers who have misrepresented their eligibility is difficult and resource intensive; and

<sup>22</sup> Other servicers have noted issues relating to Treasury's drive in July 2009 to increase the rate of trial modifications. One servicer found the meeting on July 28, 2009, as not helpful and just a forum for Treasury to tout publicly its goal of 500,000 modifications. Another complained that several servicers were made examples of for the sake of providing a certain public perspective about Treasury's oversight of the program.

- borrowers might be gaming the system by withholding required documents, (and thereby avoiding to have to make payments until the end of the trial period and still avoid foreclosure), and that some borrowers might be withholding documents to avoid disclosing misrepresentations on their original loan applications.

On balance, although Treasury's attempt to increase HAMP participation in July was certainly a laudable goal, Treasury's decision to permit trial modifications without documentation appears to have been made in error, and the diversion of resources it has created appears to have slowed the conversions to permanent modifications. Apparently recognizing this error Treasury has changed the rule requiring full documentation in advance of trial modifications initiated after April 15, 2010.

### *Repeated Changes and Clarifications in Net Present Value Models*

Repeated changes in the net present value test methodology have also caused confusion and delay in implementing HAMP. As described above, after determining that a loan meets basic eligibility requirements, a servicer will undertake a net present value test to determine whether it is economically advantageous to the investor for the loan to be modified rather than allowing the loan to continue to foreclosure. Several loan characteristics are input to Treasury's net present value model, with a resulting positive or negative numeric value. These inputs include but are not limited to the location of the home, value of mortgage, homeowner's credit score, front-end debt-to-income ratio, and delinquency status. The HAMP program provides a net present value model on the [www.hmpadmin.com](http://www.hmpadmin.com) portal that is available for servicers to use to evaluate loans for modification. According to Treasury, the portal net present value model is automatically updated to reflect data and program changes and requires no servicer support.

Since HAMP's initial roll-out, Treasury has issued changes or clarified model policies for the net present value methodology several times. Indeed, since the model parameters were first released on March 4, 2009, Treasury has issued changes or clarifications to the model nine times: April 6, 2009; June 11, 2009; July 9, 2009; July 31, 2009; August 7, 2009; September 11, 2009; November 3, 2009; November 10, 2009; and January 28, 2010. Thus far, according to Treasury, there have been three different formal versions of the model.<sup>23</sup> Appendix C contains a chart describing these changes and clarifications in the net present value methodology.

All five of the servicers interviewed in connection with this audit identified significant issues with the net present value modeling and in particular with the multiple changes over time in the model.<sup>24</sup> Issues identified included: problems in accessing the model at all, particularly early in the process; problems in getting documentation concerning the model; errors in the model; insufficient time to incorporate changes into the model for servicers not using Treasury's online version of the model; a lack of guidance and confusion with respect to retroactive application of changes to the model; and inconsistencies between the model code and the written guidance.

<sup>23</sup> In commenting on a draft of this report, Fannie Mae stated there have been four model versions.

<sup>24</sup> Large servicers — those with a book exceeding \$40 billion — may customize the base model to use modeled default rates that reflect their own portfolio experience.

One servicer opined that the problems and changes to the net present value test effectively doubled the effort needed to administer the test. Another stated that Treasury's failure to provide guidance on net present value issues resulted in delays in initiating trial modifications and negative public scrutiny due to such delays.

### *Guidance on Other HAMP Implementation Issues*

All five HAMP servicers visited by SIGTARP during this audit mentioned that they did not have clear guidance from Treasury on identifying and determining eligibility for borrowers at imminent risk of defaulting on their privately-owned mortgages. Treasury's frequently asked questions regarding HAMP, published on its administrative Web site for servicers (updated on January 8, 2010) stated that "no additional guidance is being provided at this time with respect to determining whether a non-GSE [or privately-owned] loan is in imminent default under HAMP." Treasury has advised servicers that they may, but are not required to use GSE guidance<sup>25</sup> on borrowers at risk of imminent default on their privately-owned mortgages for HAMP. However, without consistent and clear standards, it is possible that servicers will apply inconsistent criteria for modifying mortgages of borrowers at imminent risk of default on privately-owned mortgages or may even exclude borrowers who would otherwise qualify if the guidance were available.

Indeed, it has been widely reported that servicers have told borrowers that they must be delinquent to be eligible for HAMP, which is simply untrue, the whole concept of imminent default presumes that the borrower is current on his payments. Similarly, only two of the five servicers visited by SIGTARP reported that they had integrated Hope for Homeowners as an option for borrowers.<sup>26</sup> HAMP requires servicers to consider borrowers for the Hope for Homeowners refinance program as they offer modification solutions to borrowers. One of the servicers stated that Treasury promised additional details on how to integrate Hope for Homeowners but the information was still forthcoming. Without providing guidance on how to integrate Hope for Homeowners, borrowers may encounter inconsistent experiences based on their servicer and, in some cases, may not be offered a program that would assist them.

### *Servicer Capacity and Training Issues*

Traditionally, the primary role of a servicer is to collect monthly mortgage payments and to foreclose on properties when such payments are missed. In HAMP, in addition to collecting

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<sup>25</sup> On January 26, 2010, Freddie Mac issued updated guidance for servicers with respect to the income documentation and verification requirements for borrowers with Freddie Mac mortgages who must be evaluated for imminent default. Fannie Mae instructed its servicers on February 1, 2010, to use Freddie Mac's tool to identify imminent default borrowers with Fannie Mae mortgages. Imminent default borrowers will now be screened by the GSEs when they are current or less than 60 days delinquent to align with privately-owned mortgages under Treasury's HAMP guidelines.

<sup>26</sup> The Economic and Housing Recovery Act of 2008 authorized HUD to implement the Hope for Homeowners Program, which gives banks and homeowners the option to ward off foreclosure by refinancing their at risk mortgages into 30-or 40-year fixed mortgages. The program was announced October 1, 2008, and ends September 30, 2011.

monthly mortgage payments, servicers now must train personnel to follow the program guidelines in determining a borrower's eligibility, execute the program's modification waterfall, run the latest version of the net present value model, and verify income. Indeed, the servicers reported rapid increases in their staffing levels. These new personnel also needed training to implement HAMP, which likely increased the lead time to offer HAMP modifications. As an example, one servicer had not completed formal training as of our September 2009 visit, with the servicer indicating staff was not scheduled to attend training until the month following our visit. It is important for personnel to have the proper training to reinforce consistency in the execution of those modifications. Despite the importance to the program's success, all five servicers interviewed by SIGTARP in connection with the audit reported that they had received no formal guidance from Treasury on how to train their personnel to handle HAMP modification requests.

Beyond difficulties in properly training personnel, handling the ever changing documentation requirements also challenged servicers' capacity to handle borrower inquiries and applications. One servicer reported that HAMP's quick roll-out forced it to rely on a vendor to coordinate the tracking of borrower documentation upon receipt. Officials said the handling between vendor employees and servicer employees had caused inconsistencies in storage procedures, resulting in the loss of borrower documentation, a problem that has been widely reported. Another servicer called capacity to process modifications a "key constraint."

#### *Issues Relating to HAMP Marketing Efforts*

To date, Treasury has used three primary methods to market HAMP to the public: an informational Web site, community outreach events, and a telephone hotline.

- According to Treasury, its largest outreach effort is the Making Home Affordable Web site, [www.makinghomeaffordable.gov](http://www.makinghomeaffordable.gov). Launched in March 2009, the Web site provides a centralized online resource for borrowers to learn about HAMP. The site includes, among other things, a tool for borrowers to help them determine whether or not they are eligible for HAMP, a loan look-up feature, which helps borrowers determine whether or not their loans are owned by GSEs, and a listing of the documentation needed to apply for a modification. Treasury also recently added video guides and other tools to assist in converting more trial modifications to permanent status.
- Treasury participates in community outreach events, with events taking place thus far in 23 U.S. cities hit hardest by foreclosures. The events provide for face-to-face interaction among borrowers, servicers and housing counselors.
- Treasury, through the help of Fannie Mae, provides a telephone resource, the Homeowner's HOPE Hotline. Fannie Mae officials approached the non-profit Homeownership Preservation Foundation to operate a 24 hours-a-day, seven days-a-week MHA informational hotline, available in English, Spanish, and other languages upon request. The Homeownership Preservation Foundation assumed this role for the

Homeowner's HOPE Hotline in May 2009 and, as of the end of February, has recorded more than 800,000 calls, for which 95 percent related to HAMP.

As program administrator, Fannie Mae has provided an outreach toolkit with sample marketing materials on a Web site available to participating servicers (those which have signed a Servicer Participation Agreement). Treasury officials pointed to the toolkit as HAMP marketing guidelines and said they also provided the materials to members of Congress for provision to their constituents.

Notwithstanding these efforts, each of the five servicers we visited indicated more guidance was needed to develop HAMP marketing materials to better inform the public about HAMP. There was lack of a consistent message that resulted in confusion among some borrowers. Based on the servicer interviews, interviews of Treasury and GSE officials, and a review of program materials, SIGTARP has identified several limitations in the HAMP marketing and outreach efforts thus far.

- **Performance metrics are limited.** Although Treasury does count the use of the marketing efforts it does make — by tracking hits to its website, how many people come to its outreach events, and how many calls to its hotline — Treasury thus far has not tried to comprehensively gauge whether HAMP information is reaching its target audience (homeowners in trouble) effectively. As a result, it is impossible to gauge the effects of these efforts because Treasury has not developed a comprehensive way, through focus groups or more wide-ranging surveys beyond its outreach events, for example, to measure whether its efforts have been successful.
- **Treasury's efforts to use mass media advertising have been delayed and will not begin until at least April 2010.** It has taken Treasury more than a year to develop its own public service announcements<sup>27</sup> for television, the medium with arguably the best chance of reaching the broadest audience. After a series of delays, the first such broadcast media spots are not scheduled to occur until at least April, a year after modifications could begin. Putting aside whether there are homeowners who could have been helped had knowledge of HAMP been broader, the lack of basic understanding about the program has sown confusion. For example, one servicer reported that its operators repeatedly had to deal with the fact that many borrowers believed that the program was available to everyone. If Treasury were to launch its own public service announcement, it would also provide a broad opportunity to educate the public about foreclosure rescue scams. SIGTARP recognizes that Treasury's Web site and borrower outreach events present warning information regarding this type of fraud. However, SIGTARP alone has opened more than two dozen investigations into this type of fraudulent behavior, and television public service announcements could better educate the public of the dangers of these frauds.

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<sup>27</sup> Treasury stated it incorporated references to the Homeowners' HOPE Hotline and the MHA website into an existing NeighborWorks America video, which was distributed in December by the Ad Council.



- **Treasury is not providing oversight of servicers' marketing and outreach efforts.** Treasury does not collect any information regarding servicers' marketing efforts. It also cannot ensure the integrity of information disseminated to the public about HAMP, as officials do not conduct oversight of HAMP marketing materials and say they have no plans to do so in the future. An official at Treasury's Homeownership Preservation Office told us the office is not monitoring the marketing or methods servicers use to solicit borrowers and inform them about HAMP. Moreover, the official told us Treasury does not intend to monitor HAMP materials disseminated by servicers in the future, including content on servicers' Web sites. According to Treasury's Homeownership Preservation Office, it does not view marketing inconsistency or content variation as a problem that warrants oversight efforts. But, as of November 4, 2009, less than half of the participating servicers' Web sites contained information specific to HAMP,<sup>28</sup> only a little more than one third of the servicers' websites provided a link to the Making Home Affordable Web site, and only 15 provided borrowers warning information about foreclosure rescue scams.

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<sup>28</sup> At the time of our analysis on November 4, 2009, 71 servicers had signed HAMP servicer participation agreements.

## Conclusions and Recommendations

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Any examination of whether a government program is being implemented successfully must have in mind, at least as an initial frame of reference, what the stated purpose of the program was and whether the agency's goals for the program are being met. Unfortunately, in the case of HAMP, even this starting point is less than straightforward.

When HAMP was launched in the first few months of 2009, Treasury justified the program by stating that the program would “help up to 3 to 4 million at-risk homeowners avoid foreclosure,” and that it would do so “by reducing monthly payments to sustainable levels.” Notwithstanding this laudable aspiration that the program would *actually help* 3 to 4 million homeowners avoid foreclosure, Treasury has stated that the 3 to 4 million homeowner goal is not tied to how many homeowners actually receive sustainable relief and avoid foreclosure, but rather that 3 to 4 million homeowners will receive *offers* for a trial modification. Treasury's focus on how many offers are given out for trial modifications — without setting goals for how many of those offers result in trial modifications or how many of the resulting trial modifications become permanent and thus actually attain the aspiration of helping homeowners avoid foreclosure and stay in their homes for a meaningful period of time — raises issues for how the program was justified and how Treasury is now measuring its progress.

First, defining success by how many offers are given can reasonably be perceived as essentially meaningless. As an extreme example, Treasury could reach, even exceed, its goal with only assisting few homeowners: if offers were given to four million at-risk homeowners, but only a very few accept that offer — because the homeowner is hopelessly underwater, because even the reduced payments are unaffordable, because the homeowner does not understand the terms well enough to take action, or for any other reason — few would be helped and the program would be an abject failure, despite meeting Treasury's stated goal. To be meaningful, Treasury's goal for HAMP must relate to how many people are helped to avoid foreclosure; because offers standing alone do not actually assist homeowners, it is simply not a useful measure.

Second, even if Treasury's goal were construed to measure how many trial modifications were started, that measure too would not be terribly illuminating. Experience thus far has shown that a substantial number of homeowners entering trial modifications never convert to permanent modifications, and a Treasury official informed SIGTARP that it is expected that only 50 percent to 66 percent of the estimated three million trial modifications will convert to permanent status. Although borrowers in trial modifications delay foreclosure and enjoy lowered monthly payments during the several months of the trial period, those benefits go away (and the difference between the original payment amount and the reduced trial payment amount is still owed) if the borrower fails to progress to a permanent modification. Indeed, there is an argument to be made that borrowers who enter trial modifications who do not get permanent modifications are actually harmed by the program because they end up making several additional

mortgage payments (money that they could use to secure alternative, more affordable housing) and face foreclosure anyway.

Plainly, the goal that should be developed and tracked is how many permanent modifications HAMP generates that help homeowners avoid foreclosure and stay in their homes. On that front, a year into the program, although more than a million trial modifications have been initiated, the number of conversions to active permanent modifications thus far, 168,708, has been, even according to Treasury, “disappointing.” Indeed, a Treasury official’s estimate for how many permanent modifications will result from HAMP — 1.5 to 2 million over the course of the four-year program — is a small fraction of how many foreclosures are expected to occur during that period. Approximately 2.8 million homeowners received foreclosure filings just in 2009, and millions more are expected in 2010, with some estimates predicting that the number will eclipse the already staggering 2009 number. It is the current estimated number of permanent modifications, which would average between 500,000 and 667,000 permanent modifications in the remaining three years of the program, and not Treasury’s still repeated 3 to 4 million figure, that should inform the debate on whether HAMP is worth the considerable time and resources that are being expended or whether the program needs to be revamped to actually help more at-risk borrowers. Transparency and accountability demand that Treasury establishes goals that are meaningful, and that it report its progress in meeting such meaningful goals on a monthly basis. Continuing to frame HAMP’s success around the number of “offers” extended is simply not sufficient.

Turning from goals to implementation, there are several reasons for the disappointing results thus far, and the participants in the program have pointed fingers at one another: Treasury has blamed the mortgage servicers for not doing enough to move borrowers into permanent modifications; the servicers have blamed Treasury for a lack of guidance and ever-changing program rules; and both Treasury and the servicers have blamed borrowers for failing to submit required documentation in a timely manner. This audit, which focuses only on Treasury’s performance, has identified several issues with Treasury’s implementation of HAMP that have negatively affected HAMP’s success thus far:

Repeated changes to program guidelines caused confusion and delay. Treasury attempted to rollout HAMP as fast as possible and made substantial progress in meeting its servicer participation goals in a short period of time: the program was announced in February 2009; the initial program guidelines were released in March 2009; and the first servicers signed agreements in April 2009. Program rules had not been fully developed, however, by the time the program began, and Treasury has had to revise guidelines repeatedly, often causing confusion and delay. The rules relating to what documents are required to be submitted by borrowers, for example, have been changed and/or clarified multiple times since the initial rules were released in March 2009, and the net present value test model and related guidance has been changed or clarified *nine times*, prompting one servicer to estimate that the model changes doubled the amount of time that it took to administer the test. Although Treasury’s desire to launch the program as soon as possible was laudable, and some changes to a program as complex as HAMP are inevitable, taking more time at the outset to adequately plan and test HAMP procedures, in the long run,

may have resulted in more permanent modifications faster, and with fewer complications, than what has occurred.

Permitting unverified verbal modifications was counterproductive. In July 2009, the Administration set a target of reaching 500,000 trial modifications by November 2009, and Treasury undertook several steps to speed up the pace of trial modifications to meet that target, including expanding outreach efforts and pressuring servicers by publicly reporting results on a servicer-by-servicer basis.

Although the trial modification target was reached as a result, it is now clear that permitting trial modifications without document verification was a mistake that, among other things, has contributed to the slow pace of converting trial modifications into permanent modifications since then, and may have arguably caused actual harm to homeowners placed into trial modifications that had no chance of becoming permanent. The resulting increase in trial modifications has created a large backlog of trial modifications that includes many borrowers who may never provide the required documentation. Servicers have reported that weeding out ineligible borrowers amongst those who entered the program through verbal information is very resource intensive, monopolizing scarce resources that could have been used to process the completed written applications of eligible borrowers. Treasury has recognized this error and has changed the rule for all trial modifications initiated after April 15, 2010.

Marketing efforts concerning HAMP have been limited. To date, Treasury has used three primary methods to market HAMP to the public: an informational Web site, community outreach events, and a telephone hotline. As program administrator, Fannie Mae also provides an outreach toolkit with sample marketing materials on a Web site available to participating servicers. Several limitations in the marketing efforts thus far have been identified:

- Servicers have indicated that more guidance was needed to develop HAMP marketing materials to better inform the public about the program, resulting thus far in a lack of a consistent message and confusion among some borrowers.
- Although Treasury does count the use of its marketing efforts — by tracking hits to its Web site, how many people come to its outreach events, and how many call its hotline — Treasury thus far has not tried to comprehensively gauge whether HAMP information is reaching its target audience (homeowners in trouble) effectively.
- Treasury does not collect any information regarding servicers' marketing efforts and thus does not know whether the servicers are attempting to provide information to the borrowers they service and cannot ensure the integrity of information disseminated to the public about HAMP.
- It has taken Treasury more than a year to develop HAMP-specific unique public service announcements for television, the medium with arguably the best chance of reaching the broadest audience. Putting aside whether there are homeowners who could have been helped had knowledge of HAMP been broader, the lack of basic understanding about the

program has sown confusion. If Treasury were to launch its own public service announcements, it would also provide another opportunity to educate the public about foreclosure rescue scams. In the context of a media world in which non-profit groups are able to get television advertisements on the air within days of a natural disaster, it is simply inexplicable that, when facing a tsunami-sized foreclosure crisis, Treasury has taken more than a year in a four-year program to simply develop — let alone broadcast — its own HAMP-specific television message to reach borrowers.

Re-defaults threaten the long-term success of the program. Even if HAMP results in the estimated 1.5 to 2 million permanent modifications, the program will not be a long-term success if large amounts of borrowers simply re-default and end up facing foreclosure anyway. Treasury estimates that 40 percent of the mortgages that enter into HAMP modifications (trial and permanent) will re-default during the program. Although, in the final analysis, it is up to the policy makers in the Administration and Congress to determine whether it is worth spending tens of billions of dollars of taxpayer funds on a program that is assumed at its outset to fail ultimately for 40 percent of the participants, several aspects of HAMP's design make it particularly vulnerable to re-defaults:

- **Debt-to-income ratios:** HAMP reduces mortgage payments to what is deemed to be an affordable level, 31 percent of a borrower's gross monthly income. In doing this calculation, however, the only debt HAMP servicers consider is mortgage debt — the borrower's other debts (*e.g.*, car payments, student loans, credit card obligations, and second liens on the home) are not factored into the calculation — and high total debt ratios will not exclude borrowers from participating in HAMP. Spending taxpayer resources to modify the mortgage payment of a borrower is of questionable value if the borrower will be unable to meet the mortgage payment anyway because of the burden of servicing other debts. Indeed, in certain circumstances such a borrower may be better off conserving funds by finding housing at a cost less than even the modified mortgage payment.
- **Interest rate increases after modification period:** Unlike a traditional fixed-rate mortgage, if the interest rate on a HAMP modification is adjusted to below prevailing market rates, after the five-year period of the program the rate can incrementally increase by up to one percent per year, capped at the 30-year conforming fixed rate on the day the modification agreement is drafted. Borrowers, however, may be unable to meet the increasing monthly payments once the interest rate begins to increase to current market rates if their income has not increased commensurate with the interest rate adjustments. Increasing interest rates, of course, were one of the early drivers of the current foreclosure crisis, particularly as interest rates on sub-prime adjustable rate mortgages reset requiring payments beyond what many borrowers could afford.
- **Second liens:** Treasury has estimated that up to 50 percent of mortgages at risk of delinquency and foreclosure are backed by second liens. Although borrowers may receive a HAMP permanent modification on their first lien, the total monthly mortgage payments might still be unaffordable if the second lien is not also modified or

extinguished. Treasury has instituted a second lien program in which participating servicers must offer either to modify the borrower's second lien according to a defined protocol or to accept a lump sum payment from Treasury in exchange for full extinguishment of the second lien. Participation to date has been extremely limited, but with the recent signing of Bank of America, Wells Fargo, and JPMorgan Chase, it is improving.

- Negative equity and strategic defaults: HAMP does not require servicers to address negative equity (*i.e.*, when the borrower owes more than the house is worth), which has been called by an industry expert the “most important predictor of default.” It is estimated that homeowners who have negative equity (currently constituting about 25 percent of all borrowers nationwide) represent almost half of all foreclosures. In light of the amount of negative equity in the mortgages under trial modifications, resulting re-defaults, including strategic defaults, may be a factor as borrowers decide that it makes more economic sense for them to walk away from their mortgages, and rent at a lower cost, rather than continue to make payments that may never result in them obtaining equity in their home.

## Recommendations

To improve the administration of HAMP, SIGTARP recommends that the Secretary of the Treasury implement the following measures:

- Treasury needs to rectify the confusion that its own statements have caused with respect to its goals and expectations for HAMP. To permit informed debate on the program's value and effectiveness thus far, Treasury must unambiguously and prominently disclose its goals and estimates (updated over time, as necessary) of how many homeowners will actually be helped through permanent modifications, and report monthly on its progress to meeting that goal.
- Beyond just measuring modifications, Treasury should develop other performance metrics to measure over time the implementation and success of HAMP. For example, Treasury could set goals and publicly report against those goals for servicer processing times, modifications as a proportion of a servicer's loans in default, modifications as a proportion of foreclosures generally, rates of how many borrowers fall out of the program prior to permanent modification, and re-default rates. Having specific goals and metrics, and comparing performance against those goals, will be essential in further refining the program and measuring its success.
- Treasury should undertake a sustained public service campaign as soon as possible both to reach additional borrowers that could potentially be helped by the program and to arm the public with complete, accurate information about the program to avoid confusion and delay, and to prevent fraud and abuse.



- Treasury should reconsider its position that allows servicers to substitute alternative forms of income verification based on the subjective determination by the servicer, such as whether such documents are “appropriate” or relying on the servicer’s “good business judgment consistent with the judgment employed when modifying mortgage loans held under their own portfolio.” Although we certainly understand Treasury’s desire to speed up conversions from trial modifications into permanent modifications, this provision is problematic. It will be very difficult to determine from a compliance and oversight perspective whether the rule is followed: to determine whether a borrower was admitted into a permanent modification appropriately under this provision, a compliance or oversight body will need to figure out what documents a particular servicer’s own proprietary modification system would require under the circumstances and then, given that system, whether acceptance of the alternative documents constitutes good business judgment under that system. Furthermore, because servicers have both an economic and reputational incentive to convert as many trial modifications to permanent modifications as possible, this provision seriously risks being the exception that devours the rule, with servicers applying loose underwriting standards to generate higher conversion rates, which could result in waste from taxpayer-funded modifications that will eventually re-default. If Treasury believes that it is appropriate to expand the forms of income verification that it will deem acceptable, it should do so in an open and transparent manner rather than simply deferring to the servicers.
- Treasury should re-examine the program’s structure to ensure that the program is adequately minimizing the risk of re-default. If HAMP ends up being a foreclosure mitigation program that merely delays foreclosures rather than preventing them, the program will be of questionable value, particularly in light of the huge investment of taxpayer funds. A program that helps borrowers permanently avoid foreclosure is preferable (and far less wasteful of tax dollars) to one that merely kicks the proverbial foreclosure can down the road. The program as currently constituted may not adequately address the risk of re-defaults stemming from non-mortgage debt, from second liens on the property, from the partial interest rate resets after the five-year modifications end, and from the fact that many of the borrowers are hopelessly underwater with little hope of ever building equity in the home.

In sum, one year into HAMP, although Treasury has done a considerable amount of work and made progress in establishing the administrative framework of the program, Treasury must promptly address the issues raised in this report; failure to do so could result in a lost opportunity to make sure that the TARP program that was specifically intended to benefit Main Street, as well as Wall Street, succeeds. Absent a thorough review of HAMP and its goals, the program risks helping few, and for the rest, merely spreading out the foreclosure crisis over the course of several years, at significant taxpayer expense and even at the expense of those borrowers who continued to struggle to make modified, but still unaffordable, mortgage payments for months more before succumbing to foreclosure anyway. While such spreading out of the pain may in some circumstances benefit the lender/investors (who may not have to immediately recognize

losses that could accompany additional immediate foreclosures), it will have done little to accomplish EESA's explicit purpose to "help families keep their homes."

# Management Comments and Audit Response

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In its management response, which is reproduced in full in Appendix F, Treasury generally concurs with and indicates that it is working towards implementing SIGTARP's recommendations concerning the need for Treasury to (a) disclose its goals and estimates for how many homeowners will be helped through permanent modifications, (b) develop goals for other performance metrics to measure HAMP implementation and success, and (c) undertake a sustained public service campaign.

Treasury disagrees with SIGTARP's two other recommendations. First, with respect to SIGTARP's recommendation that Treasury reconsider its decision to allow servicers to substitute alternative forms of income verification, for the reasons stated in the report, SIGTARP continues to submit that verification of a requirement as central to HAMP as a borrower's income should be explicit and uniform. Accordingly, SIGTARP stands by this recommendation.

Treasury also disagrees with SIGTARP's recommendation that it should re-examine the program's structure to ensure that the program is adequately minimizing the risk of re-default. Although Treasury acknowledges that "there are alternative structures that could lower re-default rates," it asserts that the recommendation fails to acknowledge that these alternatives might limit the total number of participants in the program or could result in increasing program costs. Ultimately, if the program is plagued by high re-default rates, it will have done little to achieve the goal of assisting homeowners who would still find themselves losing their homes after an unsuccessful short-term modification. In light of the significant costs of re-default — both in terms of devoting taxpayer funds merely to delay foreclosure and in terms of potential harm to homeowners — in the final analysis, SIGTARP continues to believe that only through maximizing the number of *sustainable* permanent modifications can Treasury meet its originally stated intention to enable "homeowners to modify the terms of their mortgage to avoid foreclosure" and therefore "reduc[e] monthly payments to sustainable levels." In other words, a modification program that begins with a smaller gross number of total modifications but that results in lasting relief for a vast majority of those homeowners would be preferable to a program that starts with a higher total number of modifications upfront, but through re-defaults, ends up with fewer people being helped over the long term. As to cost, although SIGTARP does not take any position with respect to Treasury's policy determination to allocate \$50 billion of taxpayer funds for HAMP, it is worth noting that a recent Congressional Budget Office report estimated that no more than \$20 billion of these funds will be spent on HAMP payments. Treasury thus may well have the resources to change the program in a manner that will result in more sustainable modifications and still be below its planned allocation.

SIGTARP continues to recommend that Treasury should re-examine the program's structure to assure that it adequately minimizes the risk of re-default.

# Appendix A—Scope and Methodology

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We performed the audit under authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. The audit reports on the status of HAMP and specifically addresses the following objectives:

- What is the status of HAMP, and has the program met its goals for participation thus far?
- What challenges have confronted and continue to confront Treasury in implementing the program?

Our audit was completed during July 2009 to March 2010. The scope covered HAMP activities implemented between March 2009 and February 2010 with particular focus on the first-lien program.

We conducted our work at the Treasury Offices of Financial Stability and Domestic Finance in Washington D.C.; Fannie Mae's Washington, D.C. headquarters; Freddie Mac's McLean, Virginia headquarters; and five mortgage servicers. The sample of five servicers was judgmentally selected based on HAMP participation status for privately-owned mortgages, volume of SIGTARP Hotline complaints, HAMP cap allocation amount, and geographic location. Four of the servicers had signed a HAMP servicer participation agreement and one servicer had not. The unpaid principal balance of participating servicers' servicing portfolio was not available during our audit planning, and was therefore not included as a sampling criterion. Site visits to the servicers occurred from September 2009 through October 2009. We also conducted work at the Homeowner's HOPE hotline in Lock Haven, Pennsylvania, and attended borrower outreach events in Chicago, Illinois, and Woodbridge, Virginia, which were sponsored by Treasury, Fannie Mae, or Hope Now.

To assess the status and challenges confronting HAMP as well as Treasury's plans to address existing challenges, we interviewed Treasury officials from the Offices of Financial Stability and Domestic Finance and GSE officials who were involved in the policy decision-making process, including interim and permanent Chief Homeownership Preservation Officers and Fannie Mae's and Freddie Mac's Chief Executive Officers. We also discussed the status and challenges confronting HAMP with Federal Housing Finance Agency officials, as well as mortgage servicing industry experts. We interviewed servicer officials and observed the loss mitigation, collections, and HAMP operations departments at the five servicers we visited. We reviewed modification policies and procedures developed by Treasury, GSEs, and servicers, as well as reports and testimonies by Government Accountability Office, the Congressional Oversight Panel, the Office of the Comptroller for the Currency, the Office of Thrift Supervision, and industry groups. We reviewed mortgage modification complaints received through the SIGTARP Hotline. We also evaluated Treasury's weekly and monthly HAMP status reports and

other HAMP data reports produced by Fannie Mae. To determine the extent that trial modifications resulted in changes to interest rates, amortization terms, and mortgage payments, we reviewed all active trial modifications in the HAMP system of record as of November 5, 2009, for the four servicers we visited which were modifying privately-owned mortgages for HAMP at that time.

To assess the methods Treasury used to market HAMP, we analyzed and assessed the Office of Financial Stability's ("OFS") HAMP marketing and outreach strategy against the nine key practices for developing a consumer education campaign compiled by GAO.<sup>29</sup> We spoke with officials within the marketing teams at OFS and Fannie Mae to learn their roles and responsibilities, and we examined HAMP marketing policies, procedures, and budgets. In addition, we reviewed Fannie Mae's financial agency agreement to identify any specific marketing responsibilities the GSE was assigned as part of its role as HAMP program administrator. During visits with five servicers, we interviewed officials to determine the extent to which Treasury issued policies, procedures, and other guidance to assist them in developing their HAMP marketing materials. We also reviewed samples of the servicers' marketing materials, such as letters and pamphlets, and asked officials about the extent to which Treasury or Fannie Mae had reviewed such materials to determine the level of governance associated with ensuring the accuracy of information disseminated to the public. We reviewed Treasury's HAMP website ([www.makinghomeaffordable.gov](http://www.makinghomeaffordable.gov)) and 71 participating servicers' Web sites to assess the amount of information provided to borrowers about HAMP as well as to identify best practices or inconsistencies among the information provided. In addition, we interviewed Homeowner's HOPE hotline officials, listened to hotline recorded calls, and obtained those officials' reviews of the operators' handling of the calls. At the borrower outreach events in Illinois and Virginia, we observed the proceedings and the processing of individual borrowers and evaluated the material presented to borrowers by the sponsors, servicers, and non-profit counselors. We also attended a Treasury-sponsored event that educated and addressed concerns of housing counselors and community officials about HAMP.

This performance audit was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Use of Computer-Processed Data

To perform this audit, we used unaudited data provided by Treasury to report on the status of trial and official modifications. Treasury produces this information based upon data servicers report to the Investor Reporting 2 database — a transaction mortgage servicing system — which is maintained by Fannie Mae. The extent to which we captured the full universe of HAMP

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<sup>29</sup> GAO-08-43, "Digital Television Transition: Increased Federal Planning and Risk Management Could Further Facilitate the DTV Transition," 11/2007, p. 26-26, 40-43.

modifications, whether in trial period or official status, is subject to the completeness and accuracy of Investor Reporting 2.

## **Internal Controls**

SIGTARP will release a mutually exclusive audit report addressing the adequacy of HAMP internal controls later this year. Our report will address several internal control objectives, including the state of the HAMP control environment and the extent to which conflicts of interest may exist across responsible program parties. In addition, the report will examine the reliability of program data, as we previously stated its completeness and accuracy require further review.

## **Prior Coverage**

Congressional Oversight Panel, *“Foreclosure Crisis: Working Toward a Solution,”* March 6, 2009

Congressional Oversight Panel, *“An Assessment of Foreclosure Mitigation Efforts after Six Months,”* October 9, 2009

Congressional Oversight Panel, *“Taking Stock: What has the Troubled Asset Relief Program Achieved?,”* December 9, 2009

Government Accountability Office, Report No. 09-837, *“Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable,”* July 23, 2009

Government Accountability Office, Report No. 10-16, *“One Year Later, Actions are needed to Address Remaining Transparency and Accountability Challenges,”* October 8, 2009

Government Accountability Office, Report No. 10-301, *“Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements,”* December 9, 2009



# Appendix B—HAMP Stakeholders

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Several entities work with Treasury to implement HAMP. Treasury has engaged the GSEs and Bank of New York Mellon as financial agents to carry out specific program tasks. Servicers execute the modifications. Other government housing authorities and the Homeowner Preservation Foundation also have a role in HAMP. See the following descriptions of key HAMP stakeholders' roles and responsibilities.

## Treasury

Treasury's Domestic Finance and the OFS are the primary Treasury offices that developed Making Home Affordable. OFS created the Homeownership Preservation Office in November 2008, and this office serves as the Making Home Affordable Program office. The Homeownership Preservation Office is responsible solely, or in conjunction with other OFS offices, for the following program functions:

- Audit oversight
- Congressional and regulatory liaison
- Data analysis
- Establishing policies in conjunction with other Treasury departments and the GSEs
- Communicating and marketing the program (performed in conjunction with Fannie Mae), including maintaining the [www.makinghomeaffordable.gov](http://www.makinghomeaffordable.gov) website
- Oversight of program compliance and fraud prevention (performed in conjunction with Freddie Mac)

## Fannie Mae

Fannie Mae was selected to be the Program Administrator for all programs under the Homeownership Preservation Office and signed a Financial Agency Agreement with Treasury on February 18, 2009. This agreement details Fannie Mae's roles, responsibilities, and basis for compensation. As the program administrator, Fannie Mae has been tasked with assisting with creating program policies, developing a marketing plan, developing the net present value model under Treasury direction, maintaining the program system of record, preparing and producing program management reports, developing a servicer integration team to provide on-going assistance to all servicers, and integrating servicers that are new HAMP participants.

## **Freddie Mac**

Freddie Mac was selected as the HAMP compliance agent to ensure servicers are following program guidelines, and a Freddie Mac official signed a Financial Agency Agreement with Treasury on February 18, 2009. This agreement details Freddie Mac's roles, responsibilities, and basis for compensation. Freddie Mac established a separate group of employees, named the Making Home Affordable compliance team, that are firewalled<sup>30</sup> from the rest of Freddie Mac's organization. The compliance team assesses all institutions that signed a HAMP servicer participation agreement on a quarterly basis, and new data is monitored on a monthly basis.

Making Home Affordable compliance has plans to conduct announced and unannounced site visits to the servicers. Making Home Affordable compliance employs loan file and management control reviews, as well as on-site and off-site procedures to review servicers' compliance. When new servicers sign a participation agreement, Freddie Mac attempts to visit them for a "readiness" review. Freddie Mac has reviewed 11 servicers as of January 2010, which represents 16 different servicing platforms.<sup>31</sup> Freddie Mac also publishes additional HAMP guidance to servicers for the Freddie Mac portion of GSE loans that are modified.

## **Bank of New York Mellon**

Treasury selected Bank of New York Mellon in October 2008 to serve as its primary agent for custodial, accounting and auction management for TARP. With respect to HAMP, it is responsible for processing and distributing the program's incentive payments to the participating servicers.

## **Mortgage Servicers**

All servicers of GSE loans are required to evaluate those mortgages under HAMP. In order to modify privately-owned mortgages and receive incentive payments, a servicer must sign a Servicer Participation Agreement. Servicers contact borrowers who may be eligible for HAMP, and borrowers may also contact their servicer if they meet general eligibility requirements. Servicers report HAMP modifications in the program's system of record, Investor Reporting 2 database, created by Fannie Mae.

## **Federal Housing Finance Agency**

The Federal Housing Finance Agency serves as the regulator and conservator of the GSEs and has oversight of GSE loans that are eligible for HAMP. The Federal Housing Finance Agency

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<sup>30</sup> Firewalls, in this context, are organizational controls intended to minimize conflicts of interest for employees with certain sensitive program knowledge.

<sup>31</sup> Servicing platforms means each servicing entity's book of business, including legacy servicing portfolios of acquired companies (e.g., Wells Fargo would count as multiple platforms due to the inclusion of Wachovia and other acquired entities).

provides feedback for policy changes to Fannie Mae and Freddie Mac in their parallel modification programs.

## **U.S. Department of Housing and Urban Development**

The U.S. Department of Housing and Urban Development has formed a partnership with HAMP, providing free housing counselors across the United States that can assist borrowers in avoiding foreclosures. Federal Housing Authority is an agency that exists as part of the Department. Federal Housing Authority has helped keep families in their home through loss mitigation practices such as deed-in-lieu, loan modifications, pre-foreclosure sales, and forbearance, among other practices throughout the United States.

## **Homeownership Preservation Foundation**

The Homeownership Preservation Foundation's mission is to develop innovative solutions for preserving and expanding homeownership through consumer education and counseling programs. The Foundation created the Homeowner's HOPE Hotline in 2004, and Fannie Mae, on behalf of Treasury, contracted with the Foundation for the Homeowner's HOPE Hotline to become HAMP's central telephone tool. The Making Home Affordable call center launched on June 22, 2009, and intends to increase foreclosure prevention awareness, educate homeowners about their options and guide them to an optimal solution, and drive homeowners to obtain either refinance, obtain a modification, or seek financial counseling.

# Appendix C—Net Present Value Test Guidance

## Changes and Clarifications in Treasury’s Guidance on Its Net Present Value Model Parameters and Reporting

Date	Change Description
<p><b>March 4, 2009</b></p>	<p>Treasury issues guidelines that introduce its net present value model and explain how the model should be used to evaluate borrowers requesting a HAMP modification. This net present value test is supposed to compare the net present value of cash flows expected from a modification to the net present value of cash flows expected in the absence of a modification. If the net present value of the modification scenario is greater than the net present value of no modification, the net present value result is deemed positive. If the net present value test generates a positive result, the servicer is required to offer a mortgage modification to the borrower. If the test generates a negative result, modification is optional.</p> <p>The following model parameters were introduced:</p> <ul style="list-style-type: none"> <li>• The program allows the servicer to choose the discount rate — the rate that determines the value of future payments compared to payments received today — to use in the net present value model, subject to a program-determined ceiling that will be sensitive to the market-determined cost of funds.</li> <li>• The cure rates — to cure a mortgage in default is to pay all the back payments, interest, and legal fees — and re-default rates are to be obtained from a default equation with parameters based on Fannie Mae and Freddie Mac analytics and program portfolio data, except where servicers use custom parameters.</li> <li>• Property value is to be determined in accordance with the guidelines.</li> <li>• The remaining parameters — home price forecast, valuation of the house price depreciation reserve, foreclosure timelines, foreclosure costs, and real-estate owned stigma — is to come from data sets held or produced by the Federal Housing Finance Agency.</li> <li>• Servicers having at least a \$40 billion servicing book have an option to substitute a set of cure rates and re-default rates estimated based on the experience of their own aggregate portfolios.</li> </ul> <p>Additional parameters and further details of the model components for the net present value test beyond those discussed above were published separately.</p>
<p><b>April 6, 2009</b></p>	<p>The Supplemental Directive clarifies the options for borrowers with negative net present value model results and standards for retaining model documentation. It also states that Fannie Mae has developed a software application for servicers to submit loan files to the net present value calculator. Also, servicers having at least a \$40 billion servicing book — dollar value of mortgages the servicer is managing — have the option to create a version of the net present value model that uses a set of cure rates and re-default rates estimated based on the experience of their own portfolios and that guidance on required inputs for custom net present value calculations will be forthcoming.</p> <p>Treasury requires servicers to maintain detailed documentation of the net present value model, all net present value inputs and assumptions, and the net present value results each time they run the test, regardless of whether the mortgage is modified.</p>

<p><b>June 11, 2009</b></p>	<p>Treasury issues updated guidelines that further explain the following key net present value model parameters presented previously in the March 4<sup>th</sup> guidelines.</p> <ul style="list-style-type: none"> <li>• <u>Discount rate</u> – All servicers are permitted limited discretion to adjust the discount rate by up to 250 basis points. The discount rate may be as low as Freddie Mac's Primary Mortgage Market Survey weekly rate for 30-year fixed rate conforming loans. In no case may a servicer use a higher discount rate for loans in its own portfolio than the rate used for loans it services for other investors. With respect to loans owned or guaranteed by Fannie Mae or Freddie Mac, the servicer is to apply the rate specified in Fannie Mae and Freddie Mac guidance.</li> <li>• <u>Default rate</u> – The model projects the probability of default if the loan is not modified and the probability of default if the loan is modified. As HAMP performance data becomes available, the model is to be updated to reflect actual program experience. Large servicers — those with a book exceeding \$40 billion — may customize the base model to use modeled default rates that reflect their own portfolio experience.</li> <li>• <u>Home prices</u> – A servicer must use the base model's home price projection, made available by the Federal Housing Finance Agency exclusively for this program and is based on data from a broad cross-section of mortgage transactions that is to be updated quarterly.</li> <li>• <u>Foreclosed or real-estate owned discount</u> – The real-estate owned discount recognizes the deterioration in perceived value that buyers often place on a home that has been foreclosed.</li> </ul>
<p><b>July 9, 2009<sup>a</sup></b></p>	<p>Fannie Mae outlines the following enhancements under development based on servicer feedback on version 1 of the net present value model.</p> <ul style="list-style-type: none"> <li>• <u>Metropolitan statistical area level home price projection</u> – Fannie Mae simplifies the AR2 model developed for the Treasury to use in version 2 of the net present value model and allows flexibility for other servicers to use other indices (e.g., Moody's, Case Shiller, etc.).</li> <li>• <u>More granular real-estate owned discount</u> – Fannie Mae clarifies the real-estate owned discount by using the current discount for automated valuation model values — a 75 percent discount for external broker price opinions/appraisals and a 25 percent discount for internal broker price opinions/appraisals.</li> <li>• <u>Prepayment model</u> – Fannie Mae proposes a prepayment model that considers variables such as the change in modification rate versus the market rate, mark-to-market loan-to-value, and loan status. Fannie Mae further notes that relevant modification data to calibrate the prepayment model are yet not available.</li> <li>• <u>Home price decline protection payment</u> – Fannie Mae provides final rules about home price decline protection payment for version 2 of the net present value model.</li> </ul>
<p><b>July 31, 2009</b></p>	<p>Treasury issues Supplemental Directive 09-04, which introduces the home price decline protection program, an initiative designed to encourage modification of loans in markets hardest hit by falling home prices. The Supplement Directive adds the home price decline protection incentive payment as an input to the net present value model and informed the servicers that the details are to be made available in early August 2009. Servicers that integrated the base net present value model into their systems or customize the model in accordance with program requirements are responsible for ensuring that they incorporate the required home price decline protection determination functionality into their version of the net present value model.</p> <p>Also, the Supplemental Directive informs the servicers that specific details regarding the use of the home price decline protection incentive payment in the net present value model is to be provided in the documentation for version 3 of the model.</p>
<p><b>August 7, 2009</b></p>	<p>Treasury issues guidance that makes significant changes from version 2 to version 3 of the net present value model:</p>

	<ul style="list-style-type: none"> <li>• <u>Home price decline protection incentive</u> – The home price decline protection incentive is to be effective beginning September 1, 2009. (Supplemental Directive 09-04 contains the detailed policy guidelines for the Home Price Decline Protection Program.)</li> <li>• <u>Prepayment model</u> – The guidance adjusts coefficients for the prepayment model and the refinance incentive value bounds.</li> <li>• <u>Model versioning requirements</u> –Servicers are required to use the same major model version, related supplement data, and the Freddie Mac Primary Mortgage Market Survey weekly rate for the initial model run in subsequent model results.</li> <li>• <u>Test consistency requirements</u> –Servicers are required to use borrower and loan information that was initially reported correctly to determine subsequent model results.</li> <li>• <u>Term extension</u> – Loans with current remaining terms greater than 480 months should skip the term extension step. Amortization term after modification should equal the remaining term. Re-amortize and extend the loan to a maximum 40-year term in monthly increments to reach as close to the target 31 percent debt-to-income without going under.</li> <li>• <u>De-seasonalized home price index</u> – Beginning the third quarter of 2009, the home price index is to be adjusted to remove the seasonal affects of home prices and reduce the index's impact on the home price decline protection payment.</li> </ul> <p>Also, Treasury's guidance clarifies the documentation required from version 2 to version 3 of the net present value model. For example</p> <ul style="list-style-type: none"> <li>• <u>Escrow shortage</u> – Servicers are to include any future monthly escrow shortage payments to the "Association Dues/Fees Before Modification" field.</li> <li>• <u>Adjustable-rate mortgage/interest-only reset or recast</u> – For adjustable-rate mortgage/Interest-only recast that is to happen within the next four months, front-end debt-to-income is to be calculated using principal, interest, taxes, insurance, homeowners' association, and/or condominium fees based on the greater of the "Principal and Interest Payment before Modification" input field and the fully amortizing payment.</li> <li>• <u>Timing of the investor incentive and government subsidy incentive in the equations for the modification cure and default cash flows</u> – The investor incentive payment for the trial period is to be made in period 3, and the three government subsidy payments for the trial period are to remain in period 4.</li> </ul>
<b>September 11, 2009</b>	Treasury issues Supplemental Directive 09-06, which outlines data collection and reporting requirements for the net present value model. The Supplement Directive requires servicers to report loan-level data starting in October 2009 to Fannie Mae for mortgages evaluated for HAMP, including the net present value model type code and 43 other model inputs.
<b>November 3, 2009</b>	Treasury issues Supplemental Directive 09-08, which requires services who receive a borrower request within 30 calendar days from the date of notifying the borrower their loan has a negative net present value model result to provide the borrower with the date of the net present value calculation and with select input values. If, within 30 calendar days of receiving this information the borrower provides the servicer with evidence that any of these input values are inaccurate and those inaccuracies are material, the servicer is to conduct a new net present value evaluation.
<b>November 30, 2009</b>	Treasury issues Supplemental Directive 09-09, which provides guidance to servicers for the adoption and implementation of the Home Affordable Foreclosure Alternatives Program. The Home Affordable Foreclosure Alternatives Program — a part of HAMP — provides financial incentives to servicers and borrowers who utilize a short sale or a deed-in-lieu to avoid a foreclosure on an eligible mortgage. The Supplemental Directive states that the HAMP net present value model should not be used to project investor cash flows from either a short sale or deed-in-lieu and should be used only to determine borrower eligibility for a HAMP mortgage modification.



<p><b>January 28, 2010</b></p>	<p>Treasury issued Supplemental Directive 10-01, which makes the following changes to the net present value model and the use of the model results:</p> <ul style="list-style-type: none"> <li>• A borrower who has been evaluated for HAMP but does not meet the minimum eligibility criteria described in Supplemental Directive 09-01 or who meets the minimum eligibility criteria but is not qualified for HAMP by virtue of a negative net present value result, excessive forbearance or other financial reason, may request reconsideration for HAMP at a future time if they experience a change in circumstance.</li> <li>• In the event a servicer elects to forbear principal in an amount resulting in a modified interest-bearing balance that would create a current mark-to-market loan-to-value ratio less than 100 percent in negative net present value situations, the servicer is to ignore the error code and the flag for excessive forbearance that is returned by the net present value model. Updates are to be made to the model in the future to eliminate this error code.</li> <li>• Servicers are to re-evaluate a loan using the net present value model if the borrower's documented income differs from the stated income used in the borrower's initial qualifying net present value test. With respect to trial modifications after April 15, 2010, servicers may elect to offer the borrower a permanent modification without performing an additional net present value evaluation based on the borrower's verified income documentation. If the servicer elects not to perform an additional net present value evaluation in this situation, the servicer is to enter the trial period date and values for the model results when reporting to the HAMP system of record.</li> </ul>
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Note a: Because official guidance for these changes is not posted to the HAMP servicer website, this information on the net present value model is based on a July 9, 2009, Fannie Mae presentation.

Source: SIGTARP analysis of Treasury's and Fannie Mae's data.

# Appendix D—Acronyms

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<b>Acronym</b>	<b>Definition</b>
EESA	Emergency Economic Stabilization Act of 2008
GSE	Government-sponsored enterprise
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
HAMP	Home Affordable Modification Program
HUD	Department of Housing and Urban Development
MHA	Making Home Affordable
OFS	Office of Financial Stability
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
TARP	Troubled Asset Relief Program
Treasury	Department of the Treasury

# Appendix E—Audit Team Members

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This report was prepared and the review was conducted under the direction of Kurt Hyde, Deputy Special Inspector General, Office of the Special Inspector General for the Troubled Asset Relief Program.

The staff members who conducted the audit and contributed to the report include:

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# Appendix F—Treasury’s Comments

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ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 22, 2010

Neil M. Barofsky  
Special Inspector General  
Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP)  
1500 Pennsylvania Ave., NW, Suite 1064  
Washington, D.C. 20220

RE: SIGTARP Draft Audit Report

Dear Mr. Barofsky:

Thank you for the opportunity to review the draft audit report titled “Factors Affecting Implementation of the Home Affordable Modification Program (HAMP)”, to be released on an embargoed basis on or about March 23, 2010. The Department of the Treasury (Treasury) is working to continuously strengthen foreclosure mitigation efforts through HAMP. As explained below in the summary responses for each recommendation in the report, in general, we concur with the concerns expressed in the recommendations (a), (b) and (c), towards which Treasury has already taken and is taking significant steps, but do not concur with recommendations (d) and (e). In addition, we have commented on the characterization of the net present value (NPV) model contained in the audit report. A detailed description of the actions that Treasury has already taken or plans to take with regard to the concerns expressed in the recommendations will be provided to SIGTARP within 30 days of the issuance of the audit report.

Before we address our summary responses to the recommendations, we should note that Treasury appreciates the acknowledgement in the report that SIGTARP “accepts Treasury’s assertion that its goal has always been offers and not permanent modifications.” We also agree with SIGTARP’s statement that “To be meaningful, Treasury’s goal for HAMP must relate to how many people are helped to avoid foreclosure.” But we respectfully do not concur with the conclusion that that helping homeowners actually avoid foreclosure “can only occur with permanent modifications.” Our goal is to avoid preventable foreclosures among homeowners eligible for HAMP through modifications as well as alternatives to foreclosure such as short-sales and deed-in lieu, and other modification programs offered by servicers.

Through HAMP, every homeowner who is eligible for a permanent modification, who submits all required documentation and remains current during the trial period will get a permanent modification offer. Homeowners who participate in HAMP and then are denied a permanent modification because they did not meet the criteria may have alternatives other than foreclosure. The success of HAMP should be measured by how many eligible homeowners are able to avoid the pain and stigma of foreclosure by reducing their mortgage payments to affordable levels while either remaining in their homes or transitioning with dignity to more suitable housing. The number of permanent modifications is one element, but not the only element of gauging the success of HAMP programs over time.

Additionally, the approximately 170,000 permanent modifications reported in the MHA Monthly Report and identified in the audit report does not account for the approved final modifications that are awaiting acceptance by the borrower. Of the 1.1 million borrowers that have started a HAMP modification, 170,000 borrowers have entered permanent modifications, and an additional 91,000 borrowers have

received final approval from the servicers, which represents 32% of borrowers in trial periods for longer than three months and therefore eligible for a decision on a final modification.

Summary responses to SIGTARP recommendations

***Recommendation (a): Treasury should unambiguously and prominently disclose its goals and estimates (updated over time, as necessary) for how many homeowners will actually be helped through permanent modifications, and report monthly on its progress to meeting those goals.***

Treasury acknowledges that there has been confusion about what the references to “helping up to 3-4 million homeowners” meant and that Treasury’s own statements have not always been precise. Treasury notes that the Government Accountability Office (GAO) Report in July 2009 described the goal for HAMP in the way that Treasury intended - up to 3-4 million trial modification offers - but many people have assumed this number represented a goal of permanent modifications. Treasury will try in the future to be more precise.

HAMP is the largest, most complex mortgage modification program of its kind, bringing together borrowers, servicers, lenders and investors. There was little historical precedent on how to design the program, in addition to limited data on which to base estimates of potential performance. HAMP is highly transparent with regard to program performance. We publish monthly data reports on program performance – with additional data added to the report on a regular basis. Treasury’s first monthly Servicer Performance Report was released in July 2009 and contained data on program performance beginning in May 2009.

The monthly reports unambiguously and prominently state the number of permanent modifications achieved each month since November 2009. The monthly reports also report servicer-specific progress in completing permanent modifications – providing the percentage of each servicer’s pool of delinquent loans that have completed a permanent modification. The report also provides information by servicer on the percent of trial modifications converted to permanent modifications. These comparative performance metrics on completion of permanent modifications by servicer provide a good measurement of progress on meeting permanent modification goals.

***Recommendation (b): Treasury should set goals for other performance metrics to measure over time the implementation and success of HAMP, and report performance against those goals.***

Treasury agrees that performance goals and metrics are critical to the effective administration of any program. At launch there were a number of unknowns regarding implementation of the program that made it difficult to set appropriate targets. These included the number of servicers that would participate; the rate at which they could build capacity to implement the program; and the acceptance of overall program design. In addition, during the first year of operation, targets and goals were focused on short-term implementation deliverables and milestones for the program to become fully operational against the goal of up to 3-4 million trial modification offers.

Since the inception of the program, indicators of performance have been monitored closely, and Treasury has provided extensive information about performance. To ensure accountability, Treasury’s website, [www.FinancialStability.gov](http://www.FinancialStability.gov), provides transparency for a wide range of programs, including HAMP, with all of the monthly Servicer Performance Reports and program fact sheets. We have also established two additional websites to provide information about HAMP specifically – [www.hmpadmin.gov](http://www.hmpadmin.gov) and [www.MakingHomeAffordable.gov](http://www.MakingHomeAffordable.gov). These websites include comprehensive documentation and information about HAMP including, for example, complete lists of all servicers participating in the



program, copies of all contracts signed by servicers, the Supplemental Directives (SDs) that establish additional requirements for HAMP, hundreds of frequently asked questions, a white paper describing the Net Present Value (NPV) test methodology and all of the borrower application documents.

In July 2009, just three months after the first servicers signed agreements to participate in HAMP, Treasury began publishing the monthly Servicer Performance Reports. The first monthly report included one page of information reflecting the limited data available and reliable at that time, including trial modifications started and trial modifications offered. Each month we have significantly expanded the amount of data included in the monthly report, to maximize servicer accountability and program transparency. The latest report includes a copious amount of data through February 2010, for example: data on trial and permanent modifications by servicer, a list of participating servicers, trial and permanent modifications at the state and key metropolitan levels, a chart of the estimated population of borrowers eligible for HAMP, an overview of administration housing initiatives, characteristics of permanent modifications, average payment reduction, data on modifications by investor type, permanent modifications by waterfall steps, and predominant hardship reasons for permanent modifications.

In September 2009, we began to include modification performance by servicer in the monthly Servicer Performance Report to increase the accountability of servicers participating in the program. This included adding a “trial modification tracker” which tracks each servicer’s population of delinquent loans as well as what percentage of that pool has been offered a trial modification, started a trial modification and started a permanent modification. This servicer performance metric compares the relative success of each servicer in reaching its eligible pool of borrowers, and provides a clear metric of what percentage of eligible borrowers overall are being reached through HAMP. As of 2010, the reports include servicer-by-servicer comparisons of both trial modifications and permanent modifications as a percent of the servicer’s pool of loans that are sixty or more days past due.

With the lessons learned from the past several months of full capacity operations, Treasury will set specific targets for key program objectives soon and for which we will provide a further description in the detailed response letter. For example, Treasury has developed a survey of operational metrics and is collecting data from servicers on an enhanced number of performance measures, including time to answer incoming borrower calls, and time to process HAMP applications from homeowners.

***Recommendation (c): Treasury should undertake a sustained public service campaign as soon as possible both to reach additional borrowers that could potentially be helped by the program and to arm the public with complete, accurate information about the program to avoid confusion and delay, and to prevent fraud and abuse.***

Treasury will consider the audit report’s suggestion that we “comprehensively gauge whether HAMP information is reaching its target audience (homeowners in trouble) effectively,” for the implementation of the public service campaign described below. We believe the fact that more than 1.3 million homeowners have received offers for trial modifications, representing an estimated 60% of the total population of homeowners currently eligible to participate in HAMP, is a testament to the outreach efforts by Treasury and the servicers.

Treasury has taken and continues to take significant actions to supplement the efforts of servicers in terms of program outreach. Fundamentally, it is the contractual responsibility of servicers participating in HAMP to reach out to borrowers and convey information about the program to the homeowners whose loans they service.



Treasury is working with the Ad Council on a two-part public service announcement (PSA) campaign that has been underway since December 2009. For the first part of this campaign, Treasury is partnering with the U.S. Department of Housing and Urban Development (HUD) and NeighborWorks America® on a refreshed foreclosure prevention campaign. The refreshed campaign includes a new call-to-action for struggling homeowners by directing them to the Homeowner's HOPE Hotline and *MakingHomeAffordable.gov* so that they may receive free assistance with the Making Home Affordable Program from a HUD-approved housing counselor. The campaign includes both television and radio advertising that have been sent to 12,000 stations across the country, as well as web banners and outdoor advertising. The Ad Council will share regular updates about the success of the campaign with Treasury. Preliminary reports from January (the first full month of advertising) demonstrate that the advertisements have already run about 1,000, including at stations in some of the hardest-hit areas of the country, such as Detroit, Michigan; Jacksonville, Florida; and San Luis Obispo, California.

For the second phase of the campaign, Treasury and HUD are working with the Ad Council on a new multi-media campaign set to launch in late spring 2010. The new campaign will feature English and Spanish television, radio, outdoor and web advertisements, as well as fliers and other print materials. The Ad Council recently held one-on-one interviews with homeowners in Miami, Florida and Chicago, Illinois to test the various campaign approaches for effectiveness. As with the "refresh" campaign currently underway, the key message of this campaign will be that free help is available from the federal government if homeowners reach out for help.

Treasury believes that engaging in the two-part roll-out will continue to raise awareness of the program among eligible homeowners. By working with the Ad Council on these campaigns, we are able to leverage its extensive relationships to secure donated space, keeping campaign costs down but media impressions high.

***Recommendation (d): Treasury should reconsider its decision to allow servicers to substitute alternative forms of income verification based on the subjective determination by the servicer, such as whether such documents are "appropriate" or relying on the servicer's "good business judgment consistent with the judgment employed when modifying mortgage loans held under their own portfolio."***

The Supplemental Directives published by Treasury, specifically SD 09-01 and SD 10-01, clearly state the requirements for documentation of borrower income for HAMP modifications. However, these guidelines were never intended to be, and should not be, a comprehensive underwriting guide applicable to every unique borrower circumstance or to replace servicer judgment in making credit decisions for its portfolio. Although standards are important in the underwriting process, the application of good business judgment is also critical, and helps to ensure appropriate outcomes for all potentially eligible borrowers. Good business judgment is applied to include the non-traditional borrower (e.g., a recently re-employed person with an offer letter and only one associated pay stub). The updates to HAMP underwriting requirements described in the SD 09-07 and SD 10-01 reinforced the most important fraud protection measures – a requirement that servicers obtain tax returns/transcripts and a credit report for 100% of borrowers. Treasury is working with Fannie Mae to implement fraud detection procedures as contemplated in SD 09-07, targeting owner-occupancy and identity.

With regard to oversight and compliance, auditors are accustomed to evaluating organizations' application of business judgment. In addition, auditors apply their own good business judgment in assessing the nature and impact of identified exceptions. SD 10-01 specifically requires the servicers to appropriately document "the decision-making process when applying good business judgment ... and,

where applicable, reference the servicer's associated policies and procedures". Therefore, Treasury, through the compliance agent, will be able to evaluate and conclude on the applicability of the servicer's use of judgment. The compliance agent's suite of compliance activities (specifically, on-site fieldwork and loan file reviews) is constructed to assess the adequacy of the servicer's documentation, the appropriateness of the servicer's business judgment, and the consistency with which that judgment is applied.

***Recommendation (e): Treasury should re-examine the program's structure to ensure that the program is adequately minimizing the risk of re-default.***

Treasury continues to examine program parameters to improve operational efficiency and effectiveness. SD 10-01 is an example of this re-examination as it takes a major step forward in minimizing re-default risk by mandating the move to fully verified trial period plans. Beginning with trial plans offered after April 15, 2010 (June 1 Trial Plan effective date), borrowers must be fully verified and determined to be eligible for a permanent modification, subject only to timely receipt of trial period payments. This will limit the fall-out from trial to permanent to only those borrowers who fail to make trial payments.

Payment affordability under HAMP is achieved primarily through interest rate reduction, term extensions and principal forbearance. All loans permanently modified include an interest rate reduction (and the median decrease is four percentage points), 40% of modifications include term extensions and 28% have principal forbearance. HAMP supports long term sustainability by fixing the initial interest rate for five years and making term extension and principal forbearance permanent. This gives the borrower the ability to recover from the hardship that caused the initial delinquency.

After five years the interest rate is gradually increased but will never exceed an interest rate cap based on the Freddie Mac survey rate on the date of the modification. That rate is currently near historic lows. The median rate cap of permanent HAMP modifications is five percent for the life of the loan. This rate is an affordable rate over the life of loan, and represents a significant reduction from the loan's original interest rate for many borrowers, particularly those who had subprime, high rate loans.

The program design for HAMP purposely focused on achieving affordability of the first mortgage payment in an effort to preserve homeownership. It also includes a second lien modification program to provide a comprehensive affordability solution for borrowers. Failure to pay back-end or consumer loan debts will not result in the borrower losing the home. A permanent HAMP modification reinstates the delinquent first mortgage and reduces mortgage debt by a median of \$500 per month giving borrowers greater ability to control other credit obligations without fear of losing their homes to foreclosure.

We agree that there are alternative modification structures that could lower re-default rates, but the audit report's recommendation and discussion fail to acknowledge that these alternatives, taken alone, would likely result in fewer modifications and therefore fewer modifications completed and/or would significantly increase program cost.

Treasury has also continuously examined issues that can undermine program effectiveness, such as affordability challenges presented by second liens, unemployment and negative equity. Treasury has already announced and begun implementation of the Second Lien Modification Program (2MP), including three servicers - Bank of America, Wells Fargo and JPMorgan – that together account for more than \$400 billion of second lien loans. We expect other large servicers to join soon. While the focus of the program remains affordability, Treasury continues to study ideas that will enhance, albeit modestly, program outcomes for unemployed and underwater borrowers.

Additional comment on the Net Present Value model

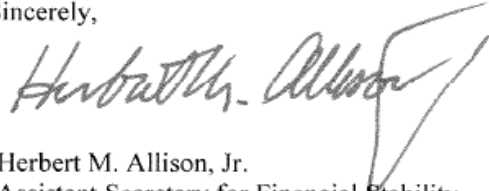
In addition to the summary responses above, Treasury has the following observations regarding the characterization that “repeated changes in net present value methodology have caused confusion and delay in implementing HAMP”:

- All servicers have had access to the fully operational portal NPV model throughout the program.
- The major changes to the NPV model have reflected improvements in that model and program adjustments in HAMP that servicers supported. We have not introduced a material change since version 3.0 in August, 2009.
- On selected servicer concerns with “doubling the time”: as noted above, a fully operational version of the NPV has been available through the portal at all times. A servicer having difficulty recoding the model into its system could and should use the portal.

Treasury shares your commitment to effective foreclosure mitigation and dedication to protecting taxpayer interests. We appreciate SIGTARP’s acknowledgment in the audit report that “Treasury has made progress in developing the administrative backbone of the program and in getting the program started rapidly”, and “Treasury has made substantial progress during the year since the announcement of HAMP in attaining servicer participation.”

We look forward to working with you and the SIGTARP team.

Sincerely,



Herbert M. Allison, Jr.  
Assistant Secretary for Financial Stability

## SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement, or misrepresentations associated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

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By *Phone*: Call toll free: (877) SIG-2009

By *Fax*: (202) 622-4559

By *Mail*:

**Hotline: Office of the Special Inspector General  
for the Troubled Asset Relief Program**  
1801 L Street., NW, 4<sup>th</sup> Floor  
Washington, D.C. 20220

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