



January 2, 2010

U.S. Loan Effort Is Seen as Adding to Housing Woes

By [PETER S. GOODMAN](#)

The Obama administration's \$75 billion program to protect homeowners from foreclosure has been widely pronounced a disappointment, and some economists and real estate experts now contend it has done more harm than good.

Since [President Obama](#) announced the program in February, it has lowered mortgage payments on a trial basis for hundreds of thousands of people but has largely failed to provide permanent relief. Critics increasingly argue that the program, Making Home Affordable, has raised false hopes among people who simply cannot afford their homes.

As a result, desperate homeowners have sent payments to banks in often-futile efforts to keep their homes, which some see as wasting dollars they could have saved in preparation for moving to cheaper rental residences. Some borrowers have seen their credit tarnished while falsely assuming that [loan modifications](#) involved no negative reports to credit agencies.

Some experts argue the program has impeded economic recovery by delaying a wrenching yet cleansing process through which borrowers give up unaffordable homes and banks fully reckon with their disastrous bets on real estate, enabling money to flow more freely through the financial system.

"The choice we appear to be making is trying to modify our way out of this, which has the effect of lengthening the crisis," said Kevin Katari, managing member of Watershed Asset Management, a San Francisco-based hedge fund. "We have simply slowed the foreclosure pipeline, with people staying in houses they are ultimately not going to be able to afford anyway."

Mr. Katari contends that banks have been using temporary loan modifications under the Obama plan as

justification to avoid an honest accounting of the mortgage losses still on their books. Only after banks are forced to acknowledge losses and the real estate market absorbs a now pent-up surge of foreclosed properties will housing prices drop to levels at which enough Americans can afford to buy, he argues.

“Then the carpenters can go back to work,” Mr. Katari said. “The roofers can go back to work, and we start building housing again. If this drips out over the next few years, that whole sector of the economy isn’t going to recover.”

The [Treasury Department](#) publicly maintains that its program is on track. “The program is meeting its intended goal of providing immediate relief to homeowners across the country,” a department spokeswoman, Meg Reilly, wrote in an e-mail message.

But behind the scenes, Treasury officials appear to have concluded that growing numbers of delinquent borrowers simply lack enough income to afford their homes and must be eased out.

In late November, with scant public disclosure, the Treasury Department started the Foreclosure Alternatives Program, through which it will encourage arrangements that result in distressed borrowers surrendering their homes. The program will pay incentives to mortgage companies that allow homeowners to sell properties for less than they owe on their mortgages — [short sales](#), in real estate parlance. The government will also pay incentives to mortgage companies that allow delinquent borrowers to hand over their deeds in lieu of foreclosing.

Ms. Reilly, the Treasury spokeswoman, said the foreclosure alternatives program did not represent a new policy. “We have said from the start that modifications will not be the solution for all homeowners and will not solve the housing crisis alone,” Ms. Reilly said by e-mail. “This has always been a multi-pronged effort.”

Whatever the merits of its plans, the administration has clearly failed to reverse the foreclosure crisis.

In 2008, more than 1.7 million homes were “lost” through foreclosures, short sales or deeds in lieu of foreclosure, according to [Moody’s Economy.com](#). Last year, more than two million homes were lost, and Economy.com expects that this year’s number will swell to 2.4 million.

“I don’t think there’s any way for Treasury to tweak their plan, or to cajole, pressure or entice servicers to do more to address the crisis,” said Mark Zandi, chief economist at Moody’s Economy.com. “For some folks, it is doing more harm than good, because ultimately, at the end of the day, they are going back into the foreclosure morass.”

Mr. Zandi argues that the administration needs a new initiative that attacks a primary source of foreclosures: the roughly 15 million American homeowners who are underwater, meaning they owe the bank more than their home is worth.

Increasingly, such borrowers are inclined to walk away and accept foreclosure, rather than continuing to make payments on properties in which they own no equity. A paper by researchers at the Amherst Securities Group suggests that being underwater “is a far more important predictor of defaults than unemployment.”

From its inception, the Obama plan has drawn criticism for failing to compel banks to write down the size of outstanding mortgage balances, which would restore equity for underwater borrowers, giving them greater incentive to make payments. A vast majority of modifications merely decrease monthly payments by lowering the interest rate.

Mr. Zandi proposes that the Treasury Department push banks to write down some loan balances by reimbursing the companies for their losses. He pointedly rejects the notion that government ought to get out of the way and let foreclosures work their way through the market, saying that course risks a surge of foreclosures and declining house prices that could pull the economy back into [recession](#).

“We want to overwhelm this problem,” he said. “If we do go back into recession, it will be very difficult to get out.”

Under the current program, the government provides cash incentives to mortgage companies that lower monthly payments for borrowers facing hardships. The Treasury Department set a goal of three to four million permanent loan modifications by 2012.

“That’s overly optimistic at this stage,” said Richard H. Neiman, the superintendent of banks for New York State and an appointee to the Congressional Oversight Panel, a body created to keep tabs on taxpayer bailout

funds. “There’s a great deal of frustration and disappointment.”

As of mid-December, some 759,000 homeowners had received loan modifications on a trial basis typically lasting three to five months. But only about 31,000 had received permanent modifications — a step that requires borrowers to make timely trial payments and submit paperwork verifying their financial situation.

The government has pressured mortgage companies to move faster. Still, it argues that trial modifications are themselves a considerable help.

“Almost three-quarters of a million Americans now are benefiting from modification programs that reduce their monthly payments dramatically, on average \$550 a month,” Treasury Secretary [Timothy F. Geithner](#) said last month at a hearing before the Congressional Oversight Panel. “That is a meaningful amount of support.”

But mortgage experts and lawyers who represent borrowers facing foreclosure argue that recipients of trial loan modifications often wind up worse off.

In Lakeland, Fla., Jaimie S. Smith, 29, called her mortgage company, then [Washington Mutual](#), in October 2008, when she realized she would get a smaller bonus from her employer, a furniture company, threatening her ability to continue the \$1,250 monthly mortgage payments on her three-bedroom house.

In April, Chase, which had taken over Washington Mutual, lowered her payment to \$1,033.62 in a trial that was supposed to last three months.

Ms. Smith made all three payments on time and submitted required documents, Chase confirms. She called the bank almost weekly to inquire about a permanent loan modification. Each time, she says, Chase told her to continue making trial payments and await word on a permanent modification.

Then, in October, a startling legal notice arrived in the mail: Chase had foreclosed on her house and sold it at auction for \$100. (The purchaser? Chase.)

“I cried,” she said. “I was hysterical. I bawled my eyes out.”

Later that week came another letter from Chase: “Congratulations on qualifying for a Making Home Affordable

loan modification!”

When Ms. Smith frantically called the bank to try to overturn the sale, she was told that the house was no longer hers. Chase would not tell her how long she could remain there, she says. She feared the sheriff would show up at her door with eviction papers, or that she would return home to find her belongings piled on the curb. So Ms. Smith anxiously set about looking for a new place to live.

She had been planning to continue an online graduate school program in supply chain management, and she had about \$4,000 in borrowed funds to pay tuition. She scrapped her studies and used the money to pay the security deposit and first month’s rent on an apartment.

Later, she hired a lawyer, who is seeking compensation from Chase. A judge later vacated the sale. Chase is still offering to make her loan modification permanent, but Ms. Smith has already moved out and is conflicted about what to do.

“I could have just walked away,” said Ms. Smith. “If they had said, ‘We can’t work with you,’ I’d have said: ‘What are my options? Short sale?’ None of this would have happened. God knows, I never would have wanted to go through this. I’d still be in grad school. I would not have paid all that money to them. I could have saved that money.”

A Chase spokeswoman, Christine Holevas, confirmed that the bank mistakenly foreclosed on Ms. Smith’s house and sold it at the same time it was extending the loan modification offer.

“There was a systems glitch,” Ms. Holevas said. “We are sorry that an error happened. We’re trying very hard to do what we can to keep folks in their homes. We are dealing with many, many individuals.”

Many borrowers complain they were told by mortgage companies their credit would not be damaged by accepting a loan modification, only to discover otherwise.

In a telephone conference with reporters, Jack Schakett, [Bank of America](#)’s credit loss mitigation executive, confirmed that even borrowers who were current before agreeing to loan modifications and who then made timely payments were reported to credit rating agencies as making only partial payments.

The biggest source of concern remains the growing numbers of underwater borrowers — now about one-third of all American homeowners with mortgages, according to Economy.com. The Obama administration clearly grasped the threat as it created its program, yet opted not to focus on writing down loan balances.

“This is a conscious choice we made, not to start with principal reduction,” Mr. Geithner told the Congressional Oversight Panel. “We thought it would be dramatically more expensive for the American taxpayer, harder to justify, create much greater risk of unfairness.”

Mr. Geithner’s explanation did not satisfy the panel’s chairwoman, Elizabeth Warren.

“Are we creating a program in which we’re talking about potentially spending \$75 billion to try to modify people into mortgages that will reduce the number of foreclosures in the short term, but just kick the can down the road?” she asked, raising the prospect “that we’ll be looking at an economy with elevated mortgage foreclosures not just for a year or two, but for many years. How do you deal with that problem, Mr. Secretary?”

A good question, Mr. Geithner conceded.

“What to do about it,” he said. “That’s a hard thing.”

[Copyright 2010 The New York Times Company](#)

[Privacy Policy](#)[Terms of Service](#)[Search](#)[Corrections](#)[RSS](#)[First Look](#)[Help](#)[Contact Us](#)[Work for Us](#)[Site Map](#)