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strangers.**July 5, 2009****FAIR GAME**

## So Many Foreclosures, So Little Logic

By [GRETCHEN MORGENSON](#)

LAST week, the stock market tumbled on news that housing foreclosures and delinquencies rose again in the first quarter. The [Office of the Comptroller of the Currency](#) said that among the 34 million loans it tracks, foreclosures in progress rose 22 percent, to 844,389. That figure was 73 percent higher than in the same period last year.

But the comptroller's office also said that amid the gloom, there was promising data about loan modifications: they rose 55 percent in the quarter. That growth came on a very low base, of course, but the move encouraged John C. Dugan, head of the comptroller's office.

"As the administration's 'Making Home Affordable' program gains traction and helps offset the impact of this very difficult economic cycle," he said in a statement, "we should continue to see progress in future reports."

A glimpse of second-quarter mortgage data, however, indicates that the progress Mr. Dugan and his colleagues in Washington are hoping for may take longer to emerge — raising questions about whether policymakers and banks are moving quickly or intelligently enough on the foreclosure problem.

Foreclosures remain one of the great financial ills for the economy. The Bush administration largely overlooked foreclosures affecting average homeowners, focusing instead on propping up elite, troubled financial institutions with taxpayer funds. The Obama administration has said it wants to wrestle the foreclosure issue to the ground by encouraging mortgage loan modifications, but its efforts have gotten little traction.

Loan modifications occur when a lender agrees to change terms of a troubled borrower's mortgage; the most common approach is to reduce the loan's interest rate. Cutting the amount of principal owed — an option that could be of more help to a borrower — is rare because it means homeowners pay less money back to the bank over time.

Lenders and their representatives, however, don't like to modify loans through interest rate cuts or principal reductions because, of course, it reduces the income they receive from borrowers. No surprise, then, that loan modifications have been a trickle amid the recent foreclosure flood.

Enter the government, with the program it announced in March to encourage modifications. It offers incentives to loan servicers to change mortgage terms, providing \$1,000 for each loan they modify. The program focuses on making payments more affordable through lower interest rates, but delinquent amounts and late fees are typically tacked onto the mortgage balance. "Making Home Affordable" does not compel

lenders to reduce mortgage balances.

Servicers signed on to the program in April. The program's early months were not covered by the O.C.C.'s first-quarter report. But other figures on modifications conducted in April, May and June are available. And they show a decline in modifications, not an increase as the government hoped.

Alan M. White, an assistant professor at the Valparaiso University law school in Indiana, [analyzed data](#) on 3.5 million subprime and alt-A mortgages in securitization pools overseen by [Wells Fargo](#). The loans were written in 2005 through 2007; data on their performance is provided to the trusts' investors. Mortgages handled by five of the nation's largest loan servicing companies — [Bank of America](#), Chase Home Finance and Litton Loan Servicing among them — are contained in the Wells Fargo data.

Mr. White found that mortgage modifications peaked in February and have declined in all but one month since. While servicers modified 23,749 loans in these trusts in February, they changed only 19,041 in May and 18,179 in June. This is exactly when servicers were supposed to be responding to the government's loan modification urgings.

Foreclosures, meanwhile, keep rising. In June, 281,560 were in process, slightly above the 277,847 in May. Last January, there were about 242,000 foreclosures in the pipeline among the Wells Fargo trusts.

"I was hoping we would see some impact in June of the government's program," Mr. White said. "Is 'Home Affordable' working? My short answer is no."

To be sure, the government's data differs from that which Mr. White analyzed, and its loan modification figures for the second quarter may look better as a result. The O.C.C. includes prime loans as well as subprime, for example, while the Wells Fargo data contains no prime loans.

Nevertheless, Mr. White has collected the figures since November 2008, and he said that in the months since, the performance of the 3.5 million mortgages that he analyzes tracked the O.C.C. data pretty closely.

THE Wells Fargo data is illuminating. It shows that in June, 58 percent of modifications cut the payments that the borrower has to pay, a slightly smaller percentage than in April or May. The average reduction in June was \$173 a month.

But the most fascinating, and frightening, figures in the data detail how much money is lost when foreclosed homes are sold. In June, the data show almost 32,000 liquidation sales; the average loss on those was 64.7 percent of the original loan balance.

Here are the numbers: the average loan balance began at almost \$223,000. But in the liquidation sale, the property sold for \$144,000 less, on average. Perhaps no other single figure shows how wildly the mortgage mania pumped up home prices. It also bodes poorly for the quality of the mortgage-related assets lurking in banks' books.

Loss severities, like foreclosures, are rising. In November, losses averaged 56.1 percent of the original loan balance; in February, 63.3 percent.

Given losses like these, Mr. White said he was perplexed that lenders and their representatives were resisting

reducing principal when they modify loans. His data shows how rare it is for lenders to reduce principal. In June, for example, 3,135 loans — just 17.2 percent of the total modified — involved write-downs of principal, interest or fees. The total loss from these write-downs was just \$45 million in June.

And yet, the losses incurred in foreclosure sales involving loans in the securitization trusts were a staggering \$4.59 billion in June. “There is 100 times as much money lost in foreclosure sales as there was in writing down balances in modifications,” Mr. White said. “That is not rational economic behavior.”

If banks have written down the value of these loans to the 40 cents on [the dollar](#) that they are fetching on foreclosures — the only true value for these homes right now — then why don't they bite the bullet and reduce the loan amount outstanding for the troubled borrowers? That type of modification would be far more likely to succeed than larding a borrower who is hopelessly underwater with yet more arrears.

“You can reduce payments with a lot of gimmicks similar to those built into subprime loans — temporary rate reductions that defer a lot of principal, balloon payments,” Mr. White said. “To me that leads to a situation where American homeowners are paying 50 to 60 percent of their incomes for mortgages which reset in 2011 and 2012. That is not solving the problem.”

Certainly not for borrowers, that is. And because many of these losses will ultimately be passed on to taxpayers, it's not solving our problem, either.

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