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## Homeowners deserve more than halfhearted mortgage relief

### The Home Affordable Modification Program has fallen far short of its goal of helping as many as 4 million borrowers. Rather than end HAMP, the government should change its focus to reducing the home loan balances of struggling people.

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Almost anywhere you look, assessments of the state of the economic recovery are muddled — job growth is positive but fading, consumer spending ebbs and flows, corporate profits are surging but corporate spending is not. The exception is housing, on which everyone agrees.

The housing market stinks.

The latest national Case-Shiller index of home prices [fell again in April](http://bit.ly/jdqAdx) from a year earlier. It was up modestly from March, but since that month marked [a new recession low,](http://bit.ly/iz9tNX) pushing average prices back to levels not seen since 2002, at best we're bumping along the bottom. About 4.5% of all mortgages are still in foreclosure, more than four times the historical average, creating an overhang of 3 million homes lost since mid-2007. Delinquencies, which mean at least one missed monthly payment, still afflict more than 8% of all mortgages.

Yet housing is the area in which the government's remedial efforts have been consistently the weakest. The gap between the government's effort to bail out bankers and its effort to bail out homeowners is a national scandal. Under the Troubled Asset Relief Program, the government's bank bailout, some $50 billion was earmarked for mortgage relief; by late last year, according to the Congressional Budget Office, only $8 billion had been committed and much less had been spent. The government's main effort to help people stay in their homes, the [Home Affordable Modification Program,](http://www.hmpadmin.com/portal/index.jsp) or HAMP, was created to assist 3 million to 4 million homeowners. As of the end of May, fewer than 700,000 had been placed in mortgages modified to better suit their financial condition so that their monthly payments were 31% or less of gross income.

HAMP hasn't been a total flop. The redefault rate of less than 20% on its mortgages is about half that of other mortgage relief programs. But it's enough of a disappointment that Treasury officials recently took a step almost unique in their regulatory record: They penalized three big banks for their shortcomings in managing HAMP. The banks are Wells Fargo, Bank of America and JP Morgan Chase; Treasury said it would withhold their scheduled monthly incentive payments under HAMP because they fell so far short of program standards. To be sure, this is a relative slap on the wrist, and anyway, the banks dispute Treasury's contention.

The shame of HAMP is that federal mortgage relief didn't have to be so halfhearted. HAMP's drafters had a successful model to work from. That was the New Deal-era [Home Owners' Loan Corp.,](http://www.nber.org/books/harr51-1) or HOLC, a program that saved 1 million homes from loss in the depths of the Great Depression and completely remade the country's mortgage market in the process. Here's the punch line: It also turned a profit for the federal government: about $14 million on a capital investment of $200 million, plus about $5 billion in borrowing.

The conditions that gave rise to HOLC weren't very different from today's. Homes had fallen in value by more than a third, and no bottom was in sight. Homeowners had no equity or owed more than their properties were worth. The typical mortgage, an interest-only short-term loan with a balloon payment, was customarily rolled over at the end of its 3- or 5-year term. That contributed to the crisis, because when the Depression hit, those automatic rollovers ceased, making foreclosures routine.

HOLC consigned those loans to history. The agency took delinquent loans off the banks' hands in return for government bonds and converted the loans to 15-year self-amortizing mortgages in today's style, so that owners could build up equity. Interest rates were reduced to no more than 5%. The existing loans were refinanced, with no loans made for more than 80% of a home's appraised value or more than $14,000.

Perhaps HOLC's most remarkable feature was its outreach. HOLC's 20,000 employees made personal contact with delinquent borrowers, sometimes even arranging jobs for unemployed homeowners or helping them find tenants. Working around temporary financial setbacks was a priority. HOLC records show as many as a dozen visits to a borrower's home, even if the loan was only a few hundred dollars. Such effort may seem impossible in today's bustling world, but HOLC was not a small operation for its era; at its peak, its loans covered 1 in 10 non-farm homes in the country.

What really enabled HOLC to succeed was that its incentives were all aimed at keeping borrowers in their homes. That's not the case with today's mortgage market, where the incentives are canted toward foreclosures. HAMP has done very little to correct that.

The key to keeping a financially strapped borrower in a home is to modify the mortgage to cut the monthly payment, whether by cutting the interest rate or loan balance or by stretching out the repayment term. What makes this difficult is that often the loan servicer — the bank or office that bills the homeowner and tracks his or her payment history — doesn't own the loan, which has been packaged and sold to investors. The servicer's right to sign off on a mortgage modification may be murky, even if in the long run it will benefit the investor by keeping the home out of foreclosure.

In fact, servicers have powerful incentives to do the wrong thing — wrong for borrowers, wrong for investors, wrong for the economy. They make more money, and have better guarantees of payment, if they delay modifications, even if they force homeowners into foreclosure.

That's because they can continue to collect junk fees from homeowners while they stretch out the process. Although they have to advance interest payments (and sometimes principal) to investors even on delinquent or defaulting loans, they're first in line to be repaid from the proceeds of the sale of a foreclosed home. Under those circumstances, why would a servicer break a sweat to keep a home out of foreclosure?

With HAMP, the Treasury Department tried to derail the foreclosure express by improving servicers' incentives to promote modifications instead. Servicers are eligible for [bonus payments of $1,500](http://bit.ly/lpzLuF) to put eligible borrowers into modified loans, with more going to investors under certain circumstances. Judging from the government's latest report and its action against the three big banks, [the effort hasn't worked](http://1.usa.gov/kjWCdm).

One of HAMP's flaws may be its reliance on the voluntary participation of the banks and other financial institutions that created the busted mortgage market in the first place. HAMP was fashioned to not rattle the banks too much, counting on them to voluntarily meet its goals rather than mandating that they reach certain modification benchmarks as a condition of getting bailed out.

But a bigger flaw is that the government's housing policy doesn't acknowledge that a genuine, lasting solution to the housing crisis means reducing the loan balances of financially stressed homeowners to levels that make sense in terms of today's sharply reduced home values.

The idea that principal reduction is the sine qua non of a lasting solution to the housing slump crosses ideological lines: Martin Feldstein, who was President Reagan's economic advisor, has proposed writing down the balance of any underwater mortgage to no more than 20% above the value of the home. (He judged that the point at which a homeowner became more likely to walk away from the loan.)

The dismal housing market tells us that the time for half-measures is past. No stimulus program would be as effective today as fixing the residential market. Yet, typically, the momentum in Congress is in the other direction, with House Republicans plotting to repeal HAMP. It's not that they have any better idea; it's that when it comes to helping the economy, they abhor anything but a vacuum.

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