The Art of the **Possible**

BY MARY LEE WIDENER

By adopting best practices for sustainable loan modifications, one non-profit is showing how effective loss mitigation can lead us out of the current crisis.

et's face it: The foreclosure crisis isn't going anywhere anytime soon. In fact, it's poised to get worse before it gets better. Yet, despite broad-based efforts for more than a year, loan modifications remain an uphill challenge. ■ Pressure is mounting on loan servicers, who are expected to work out solutions for delinquent and troubled loans. Servicers are overwhelmed with modification requests, borrowers are frustrated and feeling shut out of the opportunity and, at the time of this writing, the Obama administration is preparing for another round of industry meetings, dismayed that so little progress has been made on the loan-modification front. Meanwhile, communities across America struggle to reverse the downward pressure on property values caused by foreclosures. ■ It's a bad situation for all involved, no matter how you look at it. ■ However, by adopting broadly encouraged concepts of fairness, transparency and sustainability into the loan-modification process, the industry can avert an even larger potential problem and begin to turn the housing market around.

By the numbers

By July 2009, approximately 200,000 modifications had been performed under the administration's Making Home Affordable (MHA) program, out of the 4 million homeowners the administration hopes to help.

And when one considers the Treasury is anticipating some 3.5 million additional foreclosures in 2009, it becomes painfully evident that a paradigm shift is needed: Troubled loans need to be analyzed and resolved quickly. Loan modifications need to be made in a sustainable manner based on a full re-underwriting of the borrower and the property.

According to the Office of Thrift Supervision (OTS) and Office of the Comptroller of the Currency's (OCC's) mortgage metrics report for first-quarter 2009, even modified loans are showing signs of trouble. A full one-third of these modified loans are re-defaulting within the first quarter following modification, and nearly half are doing so within the first year.

The slow pace of modifications and their failure to achieve sustainability for both borrowers and lender portfolios points to a fundamental problem with the process. And yet, it's in everyone's best interest to make this work.

The foreclosure crisis is inextricably linked to the struggling American economy. For every foreclosed home, an entire neighborhood is put at risk and lenders stand to take hits of as much as half an asset's value in foreclosure. Every foreclosed home potentially poisons the larger well of lenders' loan portfolios while playing havoc with the lives of borrowers and whole communities.

If it's to everyone's benefit to achieve sustainable loan modifications and stem the bleeding caused by this crisis, then what's the holdup? In short, it's the need to use available best practices for loan modifications that focus on sustainability and the need to use available tools that make doing loan modifications a fast, efficient and effective process.

A light in the darkness

First, a little history on an organization that is bucking the nationwide trend.

For more than 30 years, Neighborhood Housing Services of America (NHSA), Oakland, California, has served as a bridge between investors and communities, facilitating

sustainable lending mainly to low- and moderate-income buyers in predominantly single-family neighborhoods.

Last year, while the subprime market saw foreclosure rates of 11 percent and higher, NHSA-backed loans—to lower-income borrowers who could not qualify for prime loans and would otherwise be considered subprime—held strong with a scant 1 percent foreclosure rate. The reason is simple: NHSA has always placed sustainability at the top of its list of lending requirements.

In practice, this has meant requiring at least limited borrower equity and maintaining multiple-use loss-reserve funds, including a "patient capital" component to support forbearance agreements. NHSA has also benefited from grants from Congress through NeighborWorks® America, Washington, D.C., to bring this sound lending strategy into underserved neighborhoods.

The NHSA mission is to revitalize whole neighborhoods through both innovative loan products and, more recently, through technology platforms as well, filling gaps that must be addressed if the mortgage market is to see an actual, long-term—and sustained—recovery.

At the core of this mission is the principle of fully underwriting every borrower—and every property—so that all NHSA-backed loans ensure the ability of the borrower to pay upon origination and that every transaction is fair and just.

Fair and just

Starting with the principle of fairness, NHSA believes that borrower education is a crucial—and far too often, missing—ingredient in a mortgage transaction. How many nonperforming loans could have been avoided if borrowers had thoroughly understood the terms and their responsibilities moving forward?

Whatever the number, the answer remains the same: too many.

Therefore, all NHSA loan packages must include certification that the borrower received the requisite amount of education. This is not new for NHSA; it has had this same requirement since inception 35 years ago. And borrower education is a standard practice of NeighborWorks organizations—NHSA's primary client base. This is one reason NHSA sees such a low level of foreclosures: Borrowers understand, going in, the exact nature of the loan, its terms and their responsibilities.

But it goes further than that. The borrower education practices that are used educate the borrower on what is and is not feasible—a stark contrast to the overwhelming number of subprime loans pushed onto borrowers who realistically had no chance of keeping their homes under the terms of their loans.

This is why all NHSA mortgage solutions must also be sustainable. That means the property needs to be in good condition at the time of the loan (or will be brought to good standards with the loan) and the borrower needs to be in a position to repay the mortgage.

The Obama administration's Neighborhood Stabilization Program (NSP) rests squarely on these two principles. The NSP program is providing federal funds that facilitate both rehabilitation of formerly foreclosed properties and affordability for new buyers.

Expanding the value

As NSP was launched, NHSA calibrated its technology platforms and investor channels to add value by bringing private-sector capital to NSP grant recipients in accordance with the program's rules. This new work was piloted with the Wisconsin Housing and Economic Development Authority (WHEDA), Madison, Wisconsin, in collaboration with State Farm Companies, Bloomington, Illinois, and Fannie Mae as investors. WHEDA has successfully launched this initiative and is now receiving the planned flow of private-sector capital into its housing finance agency programs.

So what does all this have to do with the current foreclosure crisis, you ask?

It's simple. The features NHSA developed in its loan products, and the technology being used to support them, are producing two critical components for any mortgage industry recovery: properties being brought back to good condition and borrowers who can afford their mortgages.

Today, servicing organizations are being overwhelmed by the modification process and are facing substantial financial losses if the cycle of foreclosures continues. The best practices adopted by NHSA can help to alleviate the risk, bring efficiency to the process and keep more Americans in their homes—salvaging whole communities and loan portfolios in the process. **MB**

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