

Lenders Compliance Group

Wednesday, February 9, 2011

The Principal Reduction Alternative



[Jonathan Foxx](#) is a former Chief Compliance Officer of two publicly traded financial institutions. He is the President and Managing Director of [Lenders Compliance Group](#), the nation's first full-service, mortgage risk management firm in the country.

About a half million permanent modifications have gone through HAMP, and 1.7 million trial modifications have been offered, even though the Obama Administration promised HAMP would assist three to four million homeowners. [Anecdotally and statistically HAMP has failed.](#)

[RealtyTrac](#) reports 2.9 million homes were in foreclosure in 2010, and 2.8 million in 2009, and 2.3 million in 2008. Furthermore, 2011 will see a 20% increase in foreclosure filings - that's above the 3 million mark! As to repossessions: approximately 2,800,000 since 2008, and still growing.

Is there a more effective way to prevent foreclosures?

HAMP - Problem or Solution?

Those who have been following our Newsletters already know that I have been highly critical of the boondoggle known as the [Home Affordable Modification Program](#) (HAMP).

Here's just a few selections from our [Archive](#):

- [HAMP: "Continues to Struggle"](#)
- [HAMP: Continues Downward Trend](#)
- [April Loan Modification Report: Is HAMP Failing?](#)

Verdict of SIGTARP

Contrasting the RealtyTrac data with HAMP statistics, the [Special Inspector General for the Troubled Asset Relief Program](#) (SIGTARP) states in a report issued on January 26, 2011:

"The number of permanent mortgage modifications under HAMP remains anemic - there were just 522,000 ongoing permanent modifications as of December 31, 2010, with approximately 238,000 of those funded by and attributable to TARP. The remaining were funded outside of TARP by the GSEs. A combined total of more than 792,000 trial and permanent modifications have been canceled, with more than 152,000 trial modification still in limbo. These permanent modification numbers pale in comparison not only to foreclosure filings, but also to Treasury's initial prediction that HAMP would 'help up to 3 to 4 million at-risk homeowners avoid foreclosure' by reducing monthly payments to sustainable levels." (My Emphasis)

An Alternative

In a brief, but very concisely worded White Paper, entitled [Principal Reduction Modification Math - A Report by Rick Rogers, JD/MBA](#), a compelling case is made for the fact that [lenders will receive far more value from principal reduction modifications than from other mortgage modifications](#). The paper is fairly technical, but well worth reading. [Rick's practice is devoted to foreclosure, mortgage default, and related matters](#), and he is an expert in Net Present Value (NPV) comparative analysis. Rick has kindly supported my wish to inform you of his

JD SUPRA ARTICLES

CONTACT US



[Newsletter Archive](#) **ARCHIVE**

UpTweet

Linkedin

[Linkedin](#)

[Jonathan Foxx - Linkedin](#)

BOOKMARK and SHARE

[SHARE](#) [f](#) [t](#) [e](#) [...](#)

PREVIOUS POSTS

PREVIOUS POSTS [6](#)

MAILING LIST



The first mortgage risk management firm in the USA devoted only to residential mortgage compliance.

Our professionals and support staff have extensive experience.

Titles Held

- Chief Compliance Officer
- General Counsel
- Compliance Counsel
- Compliance Manager
- Senior Regulator (federal)
- Senior Examiner (state)
- Quality Control VP
- Operations EVP
- Underwriting EVP
- HMDA Auditor
- Forensic Loan Auditor
- Licensing Manager
- SarBox Auditor

insights.

You can [download Rick's White Paper](#) from the HAMP section of our Library.

First just a word about the HAMP program itself. There are several moving parts to the HAMP eligibility program.

I will name a few significant aspects.

- **NPV** - the acronym for Net Present Value, when we've extricated the math and algorithm basics - is simply a calculation to decide if the lender is in a better profit position by approving a modification or would have a higher profit margin by foreclosing. It is part of HAMP procedures.
- Plus, the so-called **waterfall process**, which is really just a step-by-step analytical tool used for HAMP loan workouts. It consists of a series of calculations; however, in this case using such parameters as the gross monthly income, percentage of that gross income used to generate a target monthly payment, and so forth.
- Servicers evaluating HAMP modifications derive a **mark to market loan to value** (MTM-LTV) ratio on any loan greater than 115%. If so, a principal reduction then becomes available to reducing monthly payments to the eligible 31% of the borrower's gross income.
- Some generic rules: to get to the eligible 31% of gross income servicers reduce the interest rate, extend the loan term, even provide principal forbearance, but **only use principal reduction as a last resort**.

Nevertheless, these and certain other criteria are supposed to lead to successful permanent modifications based, among other things, on lowering the interest rate, extending the loan term, and/or reducing the loan balance until the eligible target payment is reached.

This White Paper asserts that the the **re-default rate** - the rate during the 12 months immediately following the modification - is the "single most important factor" when comparing the NPV of a standard Home Affordable Modification Program (HAMP) with the [Principal Reduction Alternative HAMP](#) (PRA HAMP) modifications.

The comparative analysis offered indicates that the more effectual means to preventing foreclosure is not through the standard HAMP but through the PRA HAMP program, because PRA HAMP not only includes the above-outlined HAMP criteria but also specifically permits the reduction of principal. However, PRA HAMP is optional and lenders determine whether or not to implement its principal reduction feature.

As the White Paper affirmatively states:

"Lenders will receive far more value from Principal Reduction modifications than from other mortgage modifications."

FRB Report

Rick cites a recent Federal Reserve Bank of New York Staff Report (FRB Report), entitled [Second Chances: Subprime Mortgage Modification and Re-Default](#), that serves to support the findings that "principal reduction modifications were included in a sufficient number for the authors [of the FRB Report] to state the following conclusion in the Abstract: '... the re-default rate declines relatively more when the payment reduction is achieved through principal forgiveness as opposed to lower interest rates.'"

Furthermore, Rick culls the following conclusion from page 30 of the FRB Report:

"Restoring the borrower's incentive to pay in this way [referring to principal reduction] nearly quadruples the reduction in re-default rates achieved by payment reductions through interest rate modifications and term extensions alone."

Put another way: **in many instances, principal reduction through PRA HAMP modalities is a more effective foreclosure prevention solution than just reducing the mortgage interest rate along with the other standard HAMP modalities.**

And by what ratio? The White Paper points out that "the FRB Report suggests 4 of every 10 standard HAMP modifications will fail, while only about 1 in 10 PRA HAMP modifications will fail."

Here is one of several suggestions offered in this White Paper:

"Consistent with the HAMP concept, a PRA HAMP modification should be mandatory for participating Lenders whenever its NPV exceeds that of both the standard HAMP modification and the "No Modification" alternatives."

Principal Reduction Alternative

Principal reduction is surely a viable means to preventing foreclosure through the PRA HAMP procedures, so it is hard to fathom why the Obama Administration continues to advance dubious claims of success relating to the HAMP program, without further encouraging lenders and servicers to make more use of PRA HAMP.

As the aforementioned SIGTARP report states:

WEBSITE



ARCHIVE-COMPLIANCE UPDATES



ARCHIVE - PUBLICATIONS



MANAGEMENT



LIBRARY



RECEIVE POSTS by EMAIL

[Subscribe to Lenders Compliance Blog](#)

SUBSCRIBE in READER



RECOMMENDED WEBSITES

[ABA Banking Journal](#)

[ARMCP - Professional Organization](#)

[Bank Law Prof Blog](#)

[Bank Lawyer's Blog](#)

[Bank Rate](#)

[Bank Think](#)

[Bankruptcy Litigation](#)

[Bloomberg](#)

[Business Insider](#)

[Calculated Risk](#)

[Consumer Finance \(CFPB\)](#)

[Default Servicing News](#)

[Financial 24](#)

[Housing Wire](#)

[HSH Associates](#)

[Inside Mortgage Finance](#)

[Jurist](#)

"Treasury's central foreclosure prevention effort designed to preserve that goal [of 'preserving homeownership'] - the Home Affordable Modification Program (HAMP) - has been beset by problems from the outset and, despite frequent retooling, **continues to fall dramatically short of any meaningful standard of success.**" (My emphasis)

The Treasury's most recent Press Release about the HAMP "Scorecard" has this rosy and promising subtitle: "[New Making Home Affordable data reveals mortgage help reaching struggling middle class, underwater and minority homeowners.](#)"

Political temporizing and vapid Press Releases are not helpful. The HAMP program is a failure, plain and simple.

Dressing HAMP up with fancy statistics and glowing pronouncements can't be convincing to those homeowners who would be better served by more aggressive and effective foreclosure prevention methodologies. Facts are stubborn things, and can't be wished away by the Obama Administration claiming that HAMP works for the "middle class, underwater and minority homeowners" - when, all the while, this government program clearly does no such thing for most of them. HAMP may be "reaching" these mortgagors, but it's really not helping them very much!

It seems to me that principal reduction through PRA HAMP should be more fully implemented and supported.

I'll give Rick Rogers the last word on the potential results of the principal reduction alternative:

"Lenders will achieve far greater financial benefits than with any current modification program, and borrowers will have a fighting chance to regain equity and security in their home."

What do you think?

I would welcome your comments.
Please feel free to email me at any time.



Lenders
Compliance
Group



Labels: [Foreclosure](#), [HAMP](#), [Home Affordable Modification Program](#), [HUD](#), [Permanent Modifications](#), [Principal Reduction Alternative](#), [Principal Reduction Alternative HAMP](#), [Treasury](#), [Trial Modifications](#)

[Home](#)

[Older Post](#)

[Law.Com](#)

[Lexology](#)

[Loan Workout](#)

[Mortgage Daily](#)

[Mortgage Fraud Blog](#)

[Mortgage Fraud Reporter](#)

[Mortgage Lender Implode-o-Meter](#)

[Mortgage Mag](#)

[Mortgage News Clips](#)

[Mortgage News Daily](#)

[Mortgage Orb](#)

[Mortgage Press](#)

[Mortgage REIT Journal](#)

[Mortgage Servicing News](#)

[National Law Journal](#)

[National Mortgage News](#)

[National Mortgage Professional](#)

[NMLS Users Forum](#)

[Realtor Mag](#)

[Reverse Mortgage Daily News](#)

[Scotsman Guide](#)

[Scotus Blog](#)

LAW.com - SEARCH



LAW.COM Quest beta
Search the Legal Web
Legal Web:

GO

Company Description

Lenders Compliance Group is the first full-service, mortgage risk management firm in the country, specializing exclusively in mortgage compliance and offering a full suite of services in mortgage banking. We are pioneers in outsourcing solutions for residential mortgage compliance. We offer our clients real-world, practical solutions to mortgage compliance issues, with an emphasis focused on operational assessment and improvement, benchmarking methodologies, Best Practices, regulatory compliance, and mortgage risk management.

Tags | Labels | Keywords | Categories

[Affiliated Business Arrangements](#) [Affiliated Service Providers](#) [Alternative Modification](#) [Borrower Eligibility](#) [CEPA](#) [compare ratio task force](#) [compare ratios](#) [Consumer Financial Protection Agency](#) [Core Compliance](#) [Credit Reports](#) [Department of Housing and Urban Development](#) [Department of Labor](#) [Employment Law](#) [Escrows](#) [Fair Labor Standards Act](#) [Fannie Mae](#) [Fannie Mae Loan Quality Initiative](#) [fha defaults](#) [Good Faith Estimate](#) [HAMP](#) [Home Affordable Modification Program](#) [HUD](#) [HUD-1 Settlement Statement](#) [Lending Compliance](#) [Loan Modifications](#) [Loan Officer Compensation](#) [loss mitigation](#) [Loss Mitigation Compliance](#) [Mortgage Compliance](#) [mortgage defaults](#) [Mortgage Disclosures](#) [mortgage fraud](#) [Mortgage NEWS](#) [Mortgage Originator Compensation](#) [Permanent Modifications](#) [Prepayment Penalties](#) [real estate fraud](#) [Regulation X](#) [Regulation Z](#) [RESPA](#) [Risk Ratings](#) [Service Release](#) [Premiums](#) [Servicing](#) [Settlement Cost Booklet](#) [Settlement Service Providers](#) [Trial Modifications](#) [Truth in Lending Act](#) [Yield Spread Premiums](#)

Information contained in this website is not intended to be and is not a source of legal advice. The views expressed are those of the contributing authors, as well as news services and websites linked hereto, and do not necessarily reflect the views or policies of Lenders Compliance Group (LCG), any governmental agency, business entity, organization, or institution. LCG makes no representation concerning and does not guarantee the source, originality, accuracy, completeness, or reliability of any statement, information, data, finding, interpretation, advice, opinion, or view presented herein.

© 2007-2011 Lenders Compliance Group, Inc. All Rights Reserved.