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Common-Sense

Solutions for Saving Homes & Communities

PICO National Network
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CENTER FOR RESPONSIBLE LENDING
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About PICO

PICO is one of the largest community-based efforts in the United States. Non-partisan and multi-cultural, PICO provides an opportunity for people and congregations to translate their faith into action. More than 40 different religious denominations and faith traditions are part of PICO. Since 1972, PICO has successfully worked to build affordable housing, redevelop communities, increase access to health care, improve public schools, make neighborhoods safer and revitalize democracy.

In addition to coordinating a nationwide foreclosure prevention campaign, PICO, for decades, has been helping families find quality, affordable housing through the development of mixed-income housing, comprehensive neighborhood reinvestment strategies, inclusionary-zoning ordinances, renter protections, housing trust funds and first-time homeownership programs.

Visit our website at **www.piconetwork.org.**

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

Visit our website at **www.responsiblelending.org.**

North Carolina
302 West Main Street
Durham, NC 27701
Ph (919) 313-8500
Fax (919) 313-8595

California
1330 Broadway
Suite 604
Oakland, CA 94612
Ph (510) 379-5500
Fax (510) 893-9300

District of Columbia
910 17th Street NW
Suite 500
Washington, DC 20006
Ph (202) 349-1850
Fax (202) 289-9009

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OPENING

Recent industry projections are that over eight million families will lose their homes to foreclosure over the next four years. That's one in every six homeowners with a mortgage. If the economy enters a deep recession, the number of homes lost could exceed 10 million.[1] With the housing sector responsible for one in eight U.S. jobs, the flood of new foreclosures will contribute to the growing unemployment rates and further constrict consumer spending.

In addition to the obvious losses imposed on affected families and their communities, these foreclosures will severely reduce tax revenues at all levels of government. They also will diminish the value of the nearly trillion dollar investment that taxpayers have made to rescue our financial institutions and stabilize the financial system. The excessive leverage, through collateralized debt obligations (CDOs) and credit default swaps of banking institutions, multiplies the losses from these foreclosures.

Banks are foreclosing on homes at a rate of approximately 40,000 per week. The failure to stem these losses imposes a cost to the taxpayers every week in lost tax revenues, in losses to the taxpayers' investments in the TARP initiative, and in deepening the nation's economic decline.

VOLUNTARY LOAN MODIFICATIONS ARE NOT STEMMING THE TIDE OF FORECLOSURES

While the causes of the current foreclosure crisis are many,[2] the response so far has been focused on voluntary modifications, a solution which has been unsuccessful. Voluntary efforts by servicers and lenders are dwarfed by the number of new foreclosures, and many of the modifications made so far have not resulted in sustainable loans for a variety of reasons discussed below. To date, the federal government has not created a systematic, large-scale system to stop those foreclosures that can reasonably be prevented.

All available data consistently indicate that continuing foreclosures far outpace total loss mitigation efforts and that only a small share of loss mitigation efforts result in true loan modifications that are likely to result in sustainable loans.

In October, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008.[3] Credit Suisse said in its December update: "While loan modifications and similar interventions (such as Hope for Homeowners FHA refinancing program) could help reduce the march of foreclosures, the proliferation of generally timid loan mod programs with confusing loan features raises significant doubt as to whether the current loan mod momentum is sufficient to reduce foreclosures materially."

Similarly, the most recent report from the State Foreclosure Working Group of Attorneys General and Banking Commissioners, which covers 13 servicers, representing 57% of the subprime market and 4.6 million subprime loans, confirms that progress in stopping foreclosures is “profoundly disappointing.”[4] Their data indicate that nearly eight out of ten seriously delinquent homeowners are not on track for any loss mitigation outcome, up from seven out of ten from the group’s last report.[5] Even the homeowners who receive some kind of loss mitigation are increasingly losing their houses through a short sale or deed-in-lieu rather than keeping the home through a loan modification or workout.

What’s more, even when modifications and other workouts are made, they are frequently temporary or unsustainable, leading to re-defaults and placing homeowners and financial institutions in an even more precarious position than when they started. According to an analysis by Valparaiso Professor of Law Alan White, a national expert on foreclosure policy, of more than 3.5 million subprime and Alt-A mortgages (all securitized), only 35% of modifications in the November 2008 report reduced monthly payments.[6]

OBSTACLES TO VOLUNTARY LOAN MODIFICATIONS

A recent Federal Reserve Staff Working Paper identifies a number of obstacles that limit the scale of modifications.[7] These obstacles help explain why voluntary loss mitigation cannot keep up with demand.

- *Investor Concerns:* Servicers may be shying away from modifications for fear of investor lawsuits.[8] While some Pooling and Servicing Agreements (PSAs) provide adequate authority to modify loans, these modifications may cause disproportionate harm to certain tranches of securities over other classes. Other PSAs include serious impediments to modifying securitized loans. For example, some limit the number or percentage of loans in a pool that can be modified.[9]

- *Second Liens:* Additional liens on a property pose a structural obstacle that is often impossible for servicers of the first lien to overcome. Between one-third and one-half of the homes purchased in 2006 with subprime mortgages have second mortgages,[10] and many more homeowners have open home equity lines of credit secured by their home. Additional lienholders generally have to give permission for loan modifications.

- *Servicer Incentives:* The way servicers are compensated by lenders creates a market-distorting bias for moving forward with foreclosure rather than engaging in foreclosure prevention. Servicers are often not paid for modifications but are reimbursed for foreclosure costs.[11] The Federal Reserve concludes, “Loan loss mitigation is labor intensive and thus raises servicing costs, which in turn make it more likely that a servicer would forego loss mitigation and pursue foreclosure, even if the investor would be better off if foreclosure were avoided.”[12]

- *Limited Servicer Staff and Technology:* With few, but welcome, recent exceptions, servicers have continued to process loan modifications in a labor-intensive, case-by-case review. While they have added staff and enhanced systems, the lack of transparent, standardized formulas has limited the number of modifications that have been produced.[13] Even when a servicer has a uniform methodology, that lack of transparency in the inputs to its net present value analysis, such as its selection of an appropriate discount rate, prevents borrowers and the public from properly evaluating modification decisions.

Data on the failure of voluntary foreclosure prevention efforts is borne out by the experience of homeowners seeking to remain in their homes and by loan counselors and community and faith-based organizations working to help stem the tide of foreclosures. Homeowners and organizations across the country face great difficulty reaching servicers, requirements that people be delinquent on their loans before they can speak to servicers, months of waiting for answers on loan modification requests, and modifications that consistently increase rather than decrease monthly payments.

While some families who have seen the value of their homes plummet and their income deteriorate have walked away, many desperately want to remain and stay current on their mortgages. Banks have long engaged in loan modification as a way to keep people in their homes under changed circumstances. The result is generally a win-win for the family who avoids the social and financial dislocation of foreclosure, for the bank that saves tens of thousands of dollars in foreclosure and disposition costs, and for taxpayers, whose property values are protected. Yet, as these stories show, all too often bureaucratic obstacles that derive from loans having been sold off to investors create perverse results that harm families and communities while making little economic sense.

TESTIMONIES

The following personal stories from homeowners in PICO communities illustrate many of the problems with the current voluntary, case-by-case approach to loan modification that lead to foreclosures that otherwise could have been prevented, including:

- The lack of transparency and standardized protocols make the loan modification process confusing and labor intensive for both borrowers and banks;

- Most loan modifications are actually short-term workouts or payment plans that raise a borrower’s monthly payments rather than lower them;

- Responsible homeowners have to fall behind in their payments in order to even be able to talk with their banks;

- Homeowners have no other recourse when a bank won’t work with them.

The lack of transparency and standardized protocols makes the process confusing and labor intensive for both borrowers and banks

Milton Barreto, Kim Machado, Gregorio Barreto
Melbourne, FL

Milton and his fiancé Kim live together in a home which Milton and his father, Gregorio, bought in July 2006 for $270,000. When they bought the house, they were told that they had a fixed-rate mortgage with a monthly payment of $1,900.

“We told them we couldn’t afford more than $1,900 a month. We made sure that we had a fixed-mortgage and we were 100% guaranteed that nothing was going to change,” recalls Kim, who helped Milton and his father negotiate since English is a second language for both of them. But in February 2007, Kim and Milton saw their monthly payments suddenly shoot up to $2,353, and then, soon afterwards, to over $2,800.

Confused as to why their payment jumped, Kim called their lender and was told that her loan had been sold to investors and was now being serviced by another bank.

After calling their lender, Kim persisted in trying to understand why their monthly payment increased. “I called and called and tried to ask why our payment went up. They kept telling me that I needed to talk to the escrow department. I left multiple messages there and never heard back from anybody. I just wanted someone to talk with me.” To this day, Kim and Milton cannot explain why their payment increased after being ensured that they had a fixed-rate mortgage.

And then the situation worsened. In late 2007, Kim, Milton, and his father – who all worked for the same kitchen and bathroom cabinetry business – lost their jobs at the same time. Luckily, Milton was able to find work at another company but not making nearly the same income as he had at his previous company where he had worked for years. After more than a year of looking for work, Kim has still been unable to find another job.

“I’ve filled out applications so far beneath me, cleaning out toilets and things like that, and I still just can’t get it,” recalls Kim, her frustration evident.

With such a major loss of income, Kim called their lender again to explain their dire situation and was told that they could apply for homeowners’ assistance, which reduced their monthly payments to $1,400 through forbearance but only for three months. The amount they were not paying during this time was added on to the principal balance, which meant that after the three month period, their monthly payment would be even higher than it was before.

When the homeowners’ assistance ended in April 2008, they were one month behind and again contacted their lender, which told them they needed to be three months behind on their payment to even talk to anybody regarding a modification. Worried about the possibility of losing their home and ruining their credit, but also unable to make their monthly payments (which were back over $2,000 a month), they stopped making their mortgage payment in the hope of qualifying for a modification.

"They told us that we had to go for a modification, and that we had to fill out an application. It was like applying for a whole new loan," recalled Kim. They submitted the application in November 2008. After numerous attempts at trying to talk with someone at the lender's office to talk about next steps, they finally spoke to a representative who told them that it would take three to four months to process their application. They were also told that after the application was processed they would get something explaining the new terms of the loan and when and where they should send their new payment. They wanted to continue making payments during this waiting period, and asked how much it should be, and were told they could not make a payment while the paperwork was being processed.

After three months, Kim and Milton still had not heard anything from their lender. In January 2009, Kim decided to call their lender to find out what was happening. "On that same day, we got a letter saying we were in 'acceleration warning,' that our modification period was over, that we were behind by four months, and that we had 32 days to pay $11,000 or we would lose the house."

Kim immediately called the bank, who informed her that she should have been paying the mortgage during the waiting period, which directly contradicted what her loan modification representative had told her.

"All in all, they added 10 years to the loan, and the payment is now up to $2,300 again and it keeps going up," says Kim, thoroughly frustrated by the entire experience. "I'd prefer to pay my mortgage rather than an attorney. But because the mortgage company thinks I'm stupid, I may have to find an attorney."

Kim and Milton are currently waiting to hear if they have one last shot at saving their home. The house that Milton bought in 2006 was worth $270,000. It's now estimated at $162,000.

Throughout the process, Kim and Milton explained that they were Hispanic and that English was a second language for Milton and his father. They questioned their lender on numerous occasions about specifics they did not understand but were told the company did not have time to look at all the details on everyone's paperwork.

Most “loan modifications” are actually short-term workouts or payment plans that raise a borrower’s monthly payments rather than lower them

Berenice Ramos, Antioch, CA

Berenice Ramos and her husband bought their home in Antioch in 2005 for $580,000, with a monthly payment of $4,000. Berenice is a former U. S. Postal Service worker who now sells insurance, and her husband is a foreman in the construction industry. They have three children.

Berenice Ramos stands in her empty bedroom on the day she lost her home.

When they took out the mortgage in 2005, they were told that they would be easily able to refinance in two years. Berenice and her husband never missed a payment for the first two years. When the construction boom began to slow down in early 2007, and her husband began losing work, they dipped into their savings to pay the mortgage. They also began cleaning houses on the side to make some extra income.

Then, in July 2007, the interest rate on their loan reset from 5.5% to 7.1%, which increased their payment by over $600 per month. With Berenice’s husband’s work still slow, and their savings now depleted, they could not keeping making the monthly payment of over $4,600.

At this point, Berenice tried contacting their bank to talk with someone about modifying their loan. She was unable to talk with anyone who would listen to her and help her figure out what to do. “We tried to work it out with the bank, but all they said to us was, ‘you got into this loan so you have to go through with it because you signed the piece of paper… . You don’t have any other choice.’”

They tried a total of five times to modify their loan, receiving three “workout” offers, each which would have increased their monthly payment by at least $400.

As they began to fall behind on their payment, Berenice and her husband kept trying to work with their lender to modify their loan. They tried a total of five times to modify, receiving three “workout” offers from their lender, each which would have increased their monthly payment by at least $400.

“They said [the workout] would be for two years, to see if we could do the payment. But we were saying ‘if we can’t make $4,000, how are we going to make a payment of $4,400?’” recalls Berenice. “For 20 years, we had perfect credit, and we never made a late payment during the previous two years, but they didn’t care.”

Increasingly desperate, Berenice and her husband attempted to sell the house on a "short-sale," receiving three separate offers from prospective buyers, but their lender would not allow the offer to go through.

At this point, they had been trying for more than a year to save their home, or, if they lost their home, to at least emerge from the situation without badly damaging their credit. The bank would not give them any other options except foreclosing.

In November 2008, Berenice, her husband and her three children were forced out of their home.

Aquilla and Elliott Clark, Kansas City, MO

Aquilla and Elliott own a home in Kansas City, MO. Aquilla is a house cleaner and her husband Elliott had been a shift manager for a security company before getting laid off in October 2008. Elliott has been unable to find work and has had difficulty getting onto the state's unemployment roster, with the recession causing long waiting periods for enrollment.

Two years ago, Aquilla had an accident and was out of work for four months. The combination of lost income and medical bills made Aquilla and Elliott fall behind on their mortgage. After almost losing their home, they were able to **arrange a "workout" program with their lender that ended up increasing their payment by approximately $300 per month**. They grudgingly accepted this arrangement because, according to Aquilla, "my husband wasn't going to let his family be on the streets."

As the recession worsens, more and more people are losing their jobs, which is leading to even more foreclosures.

By tightening their belts, Aquilla and Elliott were able to stay current on their payments until this past October when Elliott was laid off. Now relying solely on Aquilla's income as a house cleaner, they have fallen behind again on their payment, and as of the end of January, are approaching the 90-day mark when they expect to be getting a foreclosure letter from their lender.

Resigned to the prospect of losing their home, Aquilla and Elliott are preparing to move. Through a friend of theirs, they have been able to find a house to rent about 30 miles outside Kansas City, where housing is much cheaper. But it is difficult to make any definite plans for the future when they do not know when they will be forced to leave their home.

Luckily, Aquilla and Elliott's children are grown, but they are worried about what this will do to their credit if they ever wish to buy a house again.

Father Ernie Davis, Pastor, St. Therese Little Flower, Kansas City, MO

Father Davis is a pastor in Kansas City, MO, with PICO affiliate Communities Creating Opportunity. In January 2009, he helped organize a community-based loan modification event with a lender to help the lender's borrowers who were the victims of predatory lending.

The following is a reflection from Father Davis on what he sees to be the shortcomings of the lender's loan modification program.

The good news about our event was that nearly everybody who came was relieved to finally be able to speak with somebody at [the lender] who seemed to have the ability to do something. Several people told me they had been calling and speaking with people at [the lender] and not making any progress. They were motivated and trying to do the right thing, but they could have lost their homes because nobody had the authority to work with them.

The bad news is: not even at our own event were people able to receive on-the-spot modifications. Despite what we understood in planning the event, none of the counselors or loan negotiators at the event actually had the capacity to do so. There are hundreds of thousands of people trying to work through their problems, the majority of whom will most likely end up losing their homes because the bank does not have a system in place to easily decide who qualifies for a loan modification and then make authoritative decisions. [The lender] may be putting a good face on the company by holding these events, but that's not what we need. We need the bank to reduce the unnecessary barriers to people modifying their loans and create a systematic approach to modifying loans in large numbers.

Many banks are not reducing borrowers' monthly payments.

The only things offered at the event were the old conservative modifications, and we know already that half of them will fail. And fail in the short-term. People were offered the opportunity to fold their overdue payments back into their loans or pay them on the tail end. Some, who had high ARMs were offered the possibility of lower fixed interest rates. People did not see their monthly payments reduced to an affordable level, and we all know that this is key to keeping families in their homes.

I think we can be proud of ourselves that the event showed compassion and that so many people were involved and that people were glad to have the chance to meet with a counselor. But this alone isn't going to keep families in their homes and solve our housing crisis. Systematically identifying borrowers who qualify for a modification and then reaching out to these borrowers with an offer for a modification that reduces their payments is what's needed right now. When will we wake up to the crisis at hand and take some bolder steps?

Otherwise responsible homeowners have to fall behind in their payments in order to even be able to talk with their bank

Stephanie Smith, Manteca, CA

Stephanie Smith and her husband own a home in Manteca, CA. Their mortgage is through the lender. In 2006, they decided to move to Idaho because they had heard from friends that it would be a great place to raise their two children. They tried to sell their house before moving to Idaho but were unable to do so because of the declining market.

The house continued to linger on the market throughout 2007 and 2008, as the foreclosure crisis further sunk housing prices, putting the Smiths further "upside down" on their loan. The financial stress aggravated Stephanie's Crohn's disease – a dysfunction of the digestive system that can be life-threatening – and the cost of treatment put the Smiths deeper into debt.

On the brink of desperation, Stephanie and her family decided to move back to Manteca to fight to keep their home. In Stephanie's words, "We had to decide whether to stay in Idaho and lose our Manteca home and perfect credit or leave Idaho and go back to Manteca and fight for the house we owned since it did not sell. I was not going to lose the most important financial asset in my life. *It is not just a house it is our home (emphasis added)."*

More than four months after returning to California, Stephanie and her husband have still not been able to modify their mortgage. The lender told her that they needed to be four months behind to even be considered eligible for a modification.

"We have always paid our [lender] mortgage on time." says Stephanie. "We have now been told we purposely had to stop paying so that we could be four months late to qualify for a loan modification. We got a letter [in December 2008] that said in January we would be able to possibly arrange a loan modification, but there is no guarantee."

Stephanie and her family continue to wait.

Homeowners have no other recourse when a bank won't work with them

Ana Reynoso & Andy Urista, Lathrop, CA

Ana and Andy are parents of four small boys ages three to seven (including a set of twins). Ana is a real estate salesperson who is very knowledgeable about mortgage loan processes and terminology and had helped many others on a voluntary basis to modify their loans. When the real estate business began drying up in 2007, Ana lost a great deal of her income, and Andy and she faced default themselves. With her knowledge of real estate, Ana tried to negotiate for herself but was given no respect or credibility by Wells Fargo.

Desperate, she and Andy declared bankruptcy and were taken advantage of by a scam organization offering loan modification and bankruptcy services. No attorney was affiliated with the scam organization. After losing thousands of dollars through this scam, Ana and her husband Andy ended up in bankruptcy court. They continue trying to work with their lender to keep their home in a Lathrop development that is riddled with empty homes due to foreclosures.

"There is no help on either end of this nightmare," Reynoso says. "It's tough not knowing."

The following is a testimony that Ana gave at a town hall meeting on foreclosures in Stockton in December 2008.

A tearful Ana Reynoso gives testimony at a town hall meeting on the foreclosure crisis organized by People and Congregations Together, PICO's affiliate in Stockton, in December 2008.

Hello, My name is Ana Lilia Reynoso. I am a wife and the mother of four beautiful little boys. I am one of seven children. My father is a heart transplant patient and my mother is disabled.

I am also a college graduate, real estate agent, and entrepreneur at heart. In other words, I would like you to know that I am a hard worker. And by the way, I am Hispanic.

It is difficult for me to share with strangers what I can't even share with my own loved ones, in an attempt to show strength.

Back in October 2007 I saw my entire business crash before my eyes because of the market changes. From not having my next monthly mortgage, to not having food on our table, I realized I was losing the control I worked so hard to achieve.

I felt as though I was knowledgeable, experienced, and resourceful enough to figure this problem out. Just one phone call to Wells Fargo should be enough.

I made that one phone call and many, many more over the next year. During this time, I was fortunate enough to find stable employment. I thought for sure they will help me now.

But I quickly realized that I was just another inquiry, another entry, another collect call.

I told my lender that I was an agent; that I have been able to stop other people's foreclosures. Why couldn't I help myself?

The disrespect on the other end of the phone was unbelievable... I was shown no courtesy or given any tools, advice, resources or hope that I could help myself or that they were willing to help me.

I've had to fax over more than 30 pages of personal information. Time and time again only to be told that [*the lender*] *didn't have enough information. Therefore, they couldn't help me.*

The stress of this ordeal has caused many sleepless nights, a strain on my marriage and on my family, medical problems, and the mourning for the loss of my home.

I also had to stop pursuing my master's degree since I couldn't cope with losing our home and the effect it's having on my family.

Since we were unable to get any help from our lender, my husband and I have subsequently filed for bankruptcy and I have been told that since we are now in bankruptcy we can't be helped. Nothing's changed. There's no help on either end of this nightmare. They said we were not qualified for the government's Hope for Homeowners loan either.

We only filed for bankruptcy because we wanted to save our house. It was unbelievably disappointing… to find out that judges are only allowed to order loan modifications for investment property. They are powerless to help with loan modifications on primary residences. When I asked my husband what he wanted me to share with you; he said that the toughest thing is that we have not been able to get comfortable in our home. We have been feeling like we are strangers in someone else's home and they are going to come in here and kick us out any day. We still don't know when. It is tough not knowing.

I have seen how my eldest child has gone though depression, not only because of our own unstable situation. He has lost school friends who have had to move away because their families lost their homes to foreclosure. He's had to make new best friends three times since we started living here.

As a volunteer trying to find resources for others going through foreclosure, I have seen terminally ill elderly people having to spend three hours a day, on their own, trying to deal with the banks; not knowing the English language. I have seen co-workers talk about how their communities are being shattered. One community had collaboratively purchased a home as a community center, and since their primary homes have been foreclosed, now they are in danger of losing the community center.

I have seen how people lose their home to foreclosure and then rent another home that would be foreclosed shortly after. I see family members, friends, and co-workers all facing foreclosures. I am seeing how baby boomers can't retire yet. Their retirement plans have been changed.

And when I thought I had seen it all. Then came the scam artists, the people who deliberately and cruelly prey on people who are at their most vulnerable by promising to help them get modifications on their home loans.

My new year's resolution is to take back my control! We have lost an entire year of ***our*** *life to this disabling situation. We want* ***our*** *<u>life</u> back. We want our home to one day be ours. We want to start paying our mortgage so one day we can say, "We have a foundation for our future."*

LOAN MODIFICATIONS THAT WORK

Studies tracking the results obtained by different types of modifications show that certain types of modifications are much more successful than other types. According to a recent Lehman Brothers analysis, rate reduction modifications result in a more significant improvement in performance than principal and interest capitalizations that add past-due amounts onto the balance of the loan.[14] Credit Suisse reports that when interest rates or principal are reduced, the re-default rate is less than half of those for these other modifications.[15] And a recent Office of the Comptroller of the Currency (OCC) report suggests that modifications of mortgages held by a lender, rather than ones pooled into a mortgage-backed security, have been defaulting at lower rates. This data further supports the notion that sustainable modifications can be made if obstacles to doing so can be overcome.[16]

FDIC/Indy Mac

In July 2008, the Federal Deposit Insurance Corporation (FDIC) became conservator of IndyMac after it was closed by the Office of Thrift Supervision (OTS). The next month, FDIC/IndyMac began a program to systematically modify distressed mortgages and put borrowers in sustainable mortgages. The FDIC/IndyMac model compares the net present value of modifying the loan to foreclosing and losing money reselling the house. As long as the modification provides a greater return than foreclosing, the loan can be modified. All loans are converted to fixed rate loans at the Freddie Mac Survey interest rate at the time of the modification, which is currently five percent. The model establishes a clear affordability target: a 38 percent debt-to-income ratio (DTI) for total housing payments for the IndyMac first mortgage (including mortgage principal, interest, taxes, and insurance).

To reach the affordability target based on the income information they have (subject to income verification before being finalized), the model uses a three-step approach: first, reduce the interest rate to meet the DTI target; second, increase the loan period if the rate reduction was not sufficient to meet the targeted DTI; or third, defer principal if the loan is still unaffordable.

The FDIC has also introduced some important procedural initiatives to try to increase response rates. Where they have income information, they establish a pre-approved modification offer which they send to the borrower via certified mail. To accept, the borrower can return the offer in an enclosed pre-paid envelope, with a signature, a lower payment, and current income verification documentation. Where FDIC does not have borrower income information, they have used mail, phone calls and payments to counselors to try to contact borrowers.

Although there is still limited data available, the FDIC/IndyMac model is substantially reducing monthly payments for homeowners who take advantage of the program. As of January 16, 2009, 43,428 offers had been mailed (including approximately 10,000 in January). The bank had fully modified 8,513 loans, with an average monthly payment reduction of $370. IndyMac expects the number of modifications to increase substantially as additional homeowners accept the offers to modify their loans.

Implementing the new loan modification guarantee program modeled on the FDIC/IndyMac modification program would act as a strong financial incentive for servicers and investors to agree to modify loans to newly established affordability standards. Under such a program, servicers who modified loans to meet certain standards would share the losses that result from future re-defaults of these modified loans.

TESTIMONIES OF LOAN MODIFICATIONS THAT WORK

Some hope for 2009

Rafael Martinez, Antioch, CA

Rafael Martinez and his wife own a home in Pittsburg, CA that they bought in 2005 for $400,000. IndyMac Bank is their lender. Rafael is a stucco worker earning $3,600 per month at his union job. His original monthly payment was $1,895.

For over two years, Rafael and his wife paid their mortgage on time every month. Then, in early 2008, Rafael's wife lost her job, and at the same time, the construction industry slowed down and Rafael lost some of his work. They began to fall behind on their payment and soon received notice from the bank that their debt had ballooned to $420,000, and that their monthly payments would start increasing, eventually reaching $3,000 in June.

After trying unsuccessfully to negotiate with the bank to lower their monthly payments, Rafael and his wife resigned themselves to the likely prospect that they would lose their home. In an effort to at least protect their credit, Rafael tried to arrange a short-sale on his home.

Rafael Martinez stands outside his former neighbor's home – now foreclosed and abandoned – in Pittsburg, CA.

While Rafael was preparing himself for the loss of his home, IndyMac was suddenly taken over, during the summer of 2008, by the Federal Deposit Insurance Corporation (FDIC). In August, FDIC Chairwoman Sheila Bair announced an innovative program in which the bank would reach out to tens of thousands of the bank's delinquent borrowers and try to modify their loans.

On September 25, the day after Rafael and his wife had been scheduled to lose their home to foreclosure, IndyMac sent him a letter stating that he may be eligible to modify his mortgage and lower his monthly payment.

Rafael submitted the loan modification application in January 2009. IndyMac has instructed them to make monthly payments of $1,489 for the next two months while they check Rafael and his wife's income and process their application. Rafael's loan counselor is optimistic that their modification will be approved, lowering their monthly payment by $400.

Rafael says, "$1,489 would be a perfect payment." It was a close call but he's breathing easier now. With the prospect of keeping his home, Rafael is once again excited to send in his monthly mortgage payment.

POLICY RECOMMENDATIONS

Unless swift action is taken, an estimated 8.1 million families or more will lost their homes to foreclosure over the next four years, with 2.4 million in this year alone.[17] The following four policy recommendations focus on removing the obstacles that prevent the systematic, sustainable modifications needed to keep families in their homes.

> Recommendation 1: The Treasury should use TARP funds to stop preventable foreclosures by adopting a systematic loan modification approach that will result in much larger numbers of sustainable modifications.
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> Recommendation 2: Congress should change rules governing trusts so that the government can purchase whole loans out of securities and so that trust contracts do not artificially restrict modifications.
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> Recommendation 3: Congress should ensure income tax burdens do not undermine the sustainability of loan modifications.
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> Recommendation 4: Congress should lift the ban on judicial loan modifications, which would prevent hundreds of thousands of foreclosures without costing the taxpayer at all.

Recommendation 1: The Treasury should use TARP funds to stop preventable foreclosures by adopting a systematic loan modification approach that will result in much larger numbers of sustainable modifications.

The $350 billion of TARP funds allocated by Treasury to date has not addressed the problem of excessive foreclosures, in the face of clear congressional intent otherwise. It is crucial for the Treasury to use the next $350 billion TARP installment to prevent foreclosures, thereby restoring stability to the housing market and easing access to credit. The current Administration's commitment of $50-$100 billion dollars toward foreclosure prevention is a step in the right direction.[18]

As described below, Treasury should (a) adopt a systematic modification program modeled after the approach that the FDIC has been using for restructuring IndyMac Federal Bank's mortgage loans; and (b) require participating banks and thrifts to establish systematic loan modification programs for the loans held in their portfolios.

A) Treasury Should Adopt a Systematic Modification Incentive Program

Adopting FDIC's plan to guarantee sustainable loan modifications through TARP would create an efficient subsidy for modifications of loans held in private-label securities.[19] This program would act as a strong financial incentive for servicers and investors to agree to modify loans using newly-established affordability standards, modeled on the FDIC IndyMac modification program. Under such a program, servicers who modified loans to meet a 31% first mortgage debt-to-income ratio (DTI) would share the losses that result from future re-defaults of these modified loans with the Government.

This program would address one of lenders' greatest fears: the risk of loss due to borrower re-default in a falling market. The program would result in sustainable and affordable home loans for families facing foreclosure because it focuses on affordable debt-to-income ratios and caps final interest rates at the current, and low, conventional market rates. The program's analysis of the financial benefit to investors under standardized assumptions also demonstrates to investors why a successful modification is a better outcome than foreclosure. In addition, the FDIC model aligns incentives among investors and homeowners to the benefit of stabilizing home values: investors want to see modifications succeed because they share in future losses and the loan must perform for a minimum period before the guarantee kicks in. Further, since the guarantee can cover the cost of a re-modification or disposition short of foreclosure, there are substantial incentives for servicers to forego foreclosure.

In addition, a properly constructed Treasury program that subsidizes interest rate payments of borrowers to produce a 31% DTI housing payment (using the lessons learned from the FDIC guarantee program) also could be effective. Government matching of interest rate reductions would increase the financial benefit to investors of affordable modifications. However, Treasury should first require servicers to write down interest rates to a low level (such as the current conventional loan interest rate of 5%) in order to participate in the program, to ensure that investors are not rewarded for high rate loans. The government would match reductions from there. The other important requirement would be that rates would be capped at an affordable level once the government payments stopped, resulting in a gradual rise from the subsidized rate to presumably a conventional one.

Under any incentive plan, Treasury also should adopt FDIC's recommendation to pay servicers an administrative fee for each successful modification. The current compensation structure for servicers creates a perverse incentive for foreclosure rather than foreclosure prevention. Servicers often are not paid for modifications, but are reimbursed for foreclosure costs. Moreover, it often is easier and faster for a servicer to recover amounts advanced to the investor on behalf of the borrower when the servicer proceeds to foreclosure, rather than when the servicer provides a loan modification. As a result, servicers face financial disincentives to engage in loan modifications, even if investors would ultimately fare better if foreclosure were avoided. Direct payments to servicers for substantive loan modifications should be made competitive with those for foreclosures and short sales. Treasury already has the authority to do this under the existing TARP legislation and through its conservatorship of Fannie Mae and Freddie Mac.

A payment to servicers of approximately $1,000 for each modification meeting identified affordability standards would tilt the playing field toward modification. Just as Treasury pays investment advisors and other contractors under TARP to structure its equity investments or asset purchases, this program would pay the servicers who will do the work necessary to modify the mortgages under this program.

B) Require Systematic Loan Modification Programs for Participating Banks and Thrifts.

Banks face fewer obstacles to modifying loans they own than if the loans were sold, but some barriers remain. Most notably, banks may be reluctant to take the steps necessary to prevent foreclosure because such modifications would require marking down their balance sheets and weakening their capital positions. The fact that the government is providing equity through TARP that can absorb accounting losses should remove this objection.

TARP's equity injection program provides a significant lever for requiring participating banks and thrifts to adopt a systematic loan modification program for their loans held in portfolio. Since the banks would be recognizing losses they would soon bear anyway — and minimizing losses at that — Treasury should make receipt of equity from the TARP program contingent upon the adoption of a similar loan modification program.

Recommendation 2: Change rules governing trusts so that the government can purchase whole loans out of securities and so that trust contracts do not artificially restrict modifications.

The biggest problem TARP faces with respect to loan modifications is that 80% or more of recent subprime and Alt-A loans are securitized, and if the government purchases securities, the government will own just a partial interest in the cash flow generated by loans, giving it no greater rights to modify loans than other owners scattered around the globe. If the government could buy whole loans, it would have the discretion to undertake modifications free from investor restrictions. However, trusts are designed to be passive entities and are not permitted to sell whole loans, even though they have some flexibility to modify the loans or accept a refinance for less than the principal balance.

Congress should pass legislation clarifying that participation in a government-sponsored whole loan purchase program would be permitted under Real Estate Mortgage Investment Conduit (REMIC) tax rules. This change would also allow Treasury to cheaply buy second mortgages, which are proving a significant obstacle to modifications. Congress should provide that continued REMIC status (and future tax benefits) is contingent on PSAs being modified to permit (but not require) participation in the loan sale process. Finally, the SEC or Financial Accounting Standards Board would need to ensure that accounting standards change to permit these sales.

Once these changes are made, Treasury should purchase delinquent whole loans in bulk out of private securitization trusts. Once it bought such loans, Treasury would have great flexibility to modify loans to an affordable level, since there would be no outside investors involved. These loans could be purchased to the Treasury's or Federal Reserve's balance sheet, just as they are investing in Fannie Mae and Freddie Mac mortgage-backed securities, and TARP funds could be set aside to cover the risk of loss associated with these loans.

In addition, Congress should change REMIC laws to make favorable tax-free status contingent on changing the governing agreements to remove artificial obstacles to modifications even when they would benefit the investors as a whole. The loans in the vast majority of private label securities are held in real estate mortgage investment conduits (REMICs). REMICs are tax-favored instruments (income is not taxed at the entity level), and are therefore a creature of social policy. But currently, most pooling and servicing agreements (PSAs) in REMICs place substantial restrictions on loan modifications. Given that there is no investment-based expectation that tax law will forever remain unchanged, the government could, entirely safe from any takings challenge, condition future REMIC status on trustees amending the agreements to remove any artificial restrictions hamstringing modifications. Since the vast majority of PSAs require the trustee to conform the agreements to maintain REMIC status on an on-going basis without the need to seek permission from investors, trustees will need to make these changes to permit the modifications. Such a change would help make any Treasury plan significantly more effective, as it would voluntary modifications outside of such a program.

Recommendation 3: Ensure income tax burdens do not undermine the sustainability of loan modifications.

Loan modifications containing a principal write-down or, in certain circumstances, a significant interest rate reduction, potentially cause tax liability for borrowers. While the government will never likely receive these taxes, their presence could threaten loan modifications with the best chance of succeeding with the possibility of re-default, as well as discourage homeowners from seeking a modification. The Mortgage Forgiveness Debt Relief Act of 2007 forgives tax just for acquisition debt; Congress should extend "qualified mortgage debt" to all mortgage debt, including home equity debt. This point is important because so much of the current crisis was driven by refinancing rather than initial home purchase and because predatory mortgages were push-marketed to people encouraging them to use the new loan for home repair or credit consolidation. Forgiving tax on this debt when it is written off would restore equity among borrowers and prevent later problems when struggling families are surprised by a tax bill they cannot pay.

Recommendation 4: Congress should lift the ban on judicial loan modifications, which would prevent hundreds of thousands of foreclosures without costing the taxpayer at all.

The Federal Government must provide a backstop to protect those homeowners whose lenders cannot or will not agree to voluntarily modify their loans, either through the TARP initiative or otherwise. The best and only solution for these cases is to lift the ban on judicial modifications, and provided that the homeowner could sustain a market rate mortgage, allow a bankruptcy court to implement an economically rational solution that otherwise would be lost. This is an urgent corrective step that Congress must to take to empower families with no other option to hold onto to their homes.

This law would provide an important incentive to servicers to voluntarily provide loans modifications to avoid the results that a defaulting borrower could obtain in bankruptcy, particularly modifications that reduce the principal balance owed on the loan. Borrowers would have a strong incentive to accept such a modification, because the Chapter 13 payment plan is a grueling process that is very harmful to a debtor's credit history. There is substantial evidence that modifications that reduce principal perform better than modifications that leave the balance unchanged or increase it. For example, Goldman Sachs projects that lifetime default rates on subprime loans would drop from 70% for loans with no modifications to slightly over 40% for loans with principal balance writedowns. For Alt-A loans, the default rate drops from 45% to about 10%, respectively.[20] Similarly, a recent report from Credit Suisse projects that such bankruptcy law changes would reduce foreclosures by approximately 20%.[21]

Under current law, judicial modification of loans in bankruptcy court is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century and investment banks like Lehman Brothers, yet it is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence *the only debt* that bankruptcy courts are *not* permitted to modify in Chapter 13 payment plans. Eliminating this widely criticized exception would immediately help stem the tide of foreclosures *at zero cost to the U.S. taxpayer*.[22]

Impact

Adopting the four recommendations outlined above could help prevent approximately three million foreclosures over the next four years, based on analyses from various sources.

For example, in December 2008 Credit Suisse analysts estimated that 8.1million foreclosures will occur over the next four years.[23] (They also projected that this number would climb to nine million if the U.S. unemployment rate were to reach 8.0%—at end of December this rate stood at 7.2%.)[24] The analysts then applied a series of likely loan modification and re-default scenarios to their nine million foreclosure forecast, with selected results shown below:[25]

Credit Suisse Scenarios of Loan Foreclosure, Modification & Re-default

	BEST CASE	MIDDLE-RANGE	WORST CASE
# of Homeowners facing foreclosures	9.0 million	9.0 million	9.0 million
Percent of at-risk loans modified	70%	50%	30%
Re-default rate	20%	40%	60%
# of Prevented foreclosures	5.0 million	2.7 million	1.0 million
Percent of prevented Foreclosures	56%	30%	12%

The Credit Suisse 2.7 million middle-range projection of prevented foreclosures is generally consistent with the three million avoided foreclosures estimated in total by Moody's Economy.com (which projected that changes in bankruptcy law would reduce foreclosures by 800,000) and the FDIC (which estimated that some 2.2 million struggling homeowners would benefit from loan modifications.) [26] Appendix 1 shows CRL's estimate of how these benefits would be apportioned by state.

The key will be for policy-makers to adopt an aggressive multi-pronged strategy designed to (1) increase the number of at-risk homeowners who are able to modify their loans and (2) reduce the number of unsustainable modifications that result in re-default.

Conclusion

Today's foreclosure crisis is a monument to destructive lending practices—bad lending that never before had been practiced on such a large scale and with so little oversight. These practices have now undermined not only just the entire U.S. economy, but the world economy as well. There is no single solution to the challenges facing us today, but any effective policies must seek to maximize the number of families who stay in their homes. In particular, Treasury should use its TARP authority to prevent foreclosures and Congress should revise REMIC rules, ensure tax liability does not undermine modification efforts, and lift the ban on judicial restructuring of loans on primary residences. Swift action can right the U.S. economy and put our nation on the path to economic recovery.

APPENDIX 1:

CRL PROJECTIONS OF REDUCED FORECLOSURES DUE TO COURT-SUPERVISED MODIFICATIONS AND STREAMLINED LOAN MODIFICATIONS, BY STATE[27]

Note: The expected benefit of court-supervised modifications is based on a national savings of 800,000 homes as projected by Moody's Economy.com in early January 2009. Since that time, Credit Suisse has estimated that court-supervised modifications could reduce foreclosures by 20%. On a base of 8.1 MM foreclosures, this is 1.6 million homes saved—twice Moody's projection--so the benefits reported below are very conservative. See the endnotes for further details.

	Expected Benefit of Court-Supervised Modifications (Principal Writedowns)	Expected Benefit of Streamlined Loan Modifications (FDIC Plan)
Alabama	5,510	15,153
Alaska	505	1,389
Arizona	28,972	79,674
Arkansas	2,564	7,050
California	140,474	386,304
Colorado	12,871	35,396
Connecticut	6,531	17,962
Delaware	2,206	6,067
District of Columbia	1,036	2,850
Florida	160,123	440,338
Georgia	23,333	64,165
Hawaii	1,737	4,777
Idaho	2,617	7,196
Illinois	37,483	103,078
Indiana	18,894	51,960
Iowa	4,504	12,387
Kansas	3,346	9,201
Kentucky	6,604	18,162
Louisiana	6,155	16,926
Maine	2,802	7,704
Maryland	14,189	39,020
Massachusetts	10,951	30,115
Michigan	32,088	88,242
Minnesota	15,281	42,022
Mississippi	3,205	8,813
Missouri	8,190	22,521
Montana	771	2,121
Nebraska	1,980	5,446
Nevada	19,439	53,458
New Hampshire	2,079	5,718
New Jersey	24,018	66,050
New Mexico	2,400	6,601
New York	32,356	88,978
North Carolina	11,714	32,214
North Dakota	323	889
Ohio	36,631	100,735
Oklahoma	5,584	15,355

Oregon	5,149	14,159
Pennsylvania	19,654	54,047
Puerto Rico	545	1,500
Rhode Island	2,737	7,528
South Carolina	8,343	22,945
South Dakota	625	1,719
Tennessee	8,357	22,982
Texas	27,314	75,115
Utah	3,864	10,625
Vermont	630	1,733
Virginia	12,939	35,582
Washington	8,775	24,130
West Virginia	1,341	3,687
Wisconsin	9,972	27,423
Wyoming	269	739
United States (rounded)	**800,000**	**2,200,000**

NOTES

1 Credit Suisse Fixed Income Research, Foreclosure Update: Over 8 Million Foreclosures Expected (Dec. 4, 2008), p.1.

[2] See Center for Responsible Lending's October 16, 2008, testimony before the Senate Banking Committee regarding the causes of the crisis. While more details can be found in his testimony, it is clear that dangerous lending greatly inflated the housing bubble, and the resulting foreclosures of unsustainable mortgages are magnifying the damage of the bubble's collapse. Testimony is available at http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf.

[3] See Credit Suisse Fixed Income Research, *Subprime Loan Modifications Update*, October 1, 2008, p.2, *available at* http://www.credit-suisse.com/researchandanalytics [hereinafter "Credit Suisse Update"].

[4] See State Foreclosure Prevention Working Group, *Analysis of Subprime Servicing Performance*, Sept. 2008, at 2, *available at* http://www.mass.gov/Cago/docs/press/2008_09_29_foreclosure_report_attachment1.pdf.

[5] Ibid. at 6.

[6] See the Incentives of Mortgage Servicers: Myths and Realities, Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46.

[7] See the Incentives of Mortgage Servicers: Myths and Realities, Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46.

[8] See Bajaj, Vikas and Meier, Barry, *Some Hedge Funds Argue Against Proposals to Modify Mortgages*, New York Times, October 23, 2008.

[9] See Credit Suisse, *The Day After Tomorrow: Payment Shock and Loan Modifications*, April5, 2007 (noting specific examples of PSAs with various modification restrictions, including 5% by balance, 5% by loan count, limits on frequency, and limits on interest rate).

[10] Credit Suisse, Mortgage Liquidity du Jour: Underestimated No More, March 12, 2007 at 5.

[11] *See* Testimony of Eric Stein Center for Responsible Lending, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, October 16, 2008, at fn 30, *available at:* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf .

[12] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf , *The Incentives of Mortgage Servicers: Myths and Realities* (Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46), p. 15 [hereinafter "*Myths and Realities*"].

[13] Ibid. at 3, 9, 23.

[14] Lehman Bros. U.S. Securitized Products Fixed Income Research, *The Loan Modification Story So Far* (Sept. 11, 2008) p. 2.

[15] Credit Suisse Update, p.1.

[16] See OCC and OTS Mortgage Metrics Report (Third Quarter 2008), *available at* http://occ.gov/ftp/release/2008-150a.pdf [hereinafter "OCC Report"]. One of the many concerns about this report is that meaningful, sustainable loan modification efforts did not become active until the third and fourth quarters of 2008, long after the OCC's was collected including the streamlined modification programs being used by the FDIC for IndyMac Federal Bank and by Fannie Mae and Freddie Mac.

[17] CRL derived the 2009 2.4 million foreclosure estimate is based on the annualized run rate of foreclosure starts reported in 3Q 2008 MBA *National Delinquency Survey*, grossed up to reflect entire mortgage market (MBA National Delinquency Survey covers 80% of market). Projections of national foreclosures over next four years (8,100,000) was reported by Credit Suisse: See Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected*, Credit Suisse (December 4, 2008) available at http://www.nhc.org/Credit%20Suisse%20Update%2004%20Dec%2008.doc.

18 Jeanne Sahadi, *First 100 days: Obama's Burden* CNNMoney.com, January 20, 2009:
"In a letter to Democratic leaders in the House and Senate, top Obama economic aide Larry Summers promised that the administration would commit between $50 billion to $100 billion "to a sweeping effort to address the foreclosure crisis." He said the new administration would implement policies to "reduce the number of preventable foreclosures by helping to reduce mortgage payments for economically stressed but responsible homeowners." Available at http://money.cnn.com/2009/01/20/news/economy/obama_first100days/

[19] Based on following the FDIC plan's protocols at a 50% level -- details of the plan can be found at http://www.fdic.gov/consumers/loans/loanmod/index.html.

[20] Jan Hatzius and Michael A. Marshoun. *Home Prices and Credit Losses: Projections and Policy Options*. Page 18. Goldman Sachs Global ECS Research. (January 13, 2009).

[21] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Bankruptcy Law Reform: A New Tool for Foreclosure Avoidance*, Credit Suisse (January 26, 2009).

[22] For a detailed discussion of judicial loan modifications, see Testimony of Michael Calhoun, Center for Responsible Lending, Before the U.S. House of Representatives Committee on Financial Services, January 13, 2009, available at http://www.responsiblelending.org/pdfs/calhoun-testimony-1-13-09-final.pdf.

[23] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected*, Credit Suisse (December 4, 2008).

[24] *Employment Situation Summary*, U.S. Bureau of Labor Statistics Economic News Release (January 9, 2009) available at http://www.bls.gov/news.release/empsit.nr0.htm.

[25] Ibid. Exhibit 10 at p. 7.

[26] Moody's Economy.com estimate of 800,000 borrowers benefitting from court-supervised modifications and state proportion of 3Q 2008 seriously delinquent loans as reported in 3Q 2008 MBA National Delinquency Survey; See Elizabeth Williamson and Ruth Simon, *Plan to Cut Foreclosure Rate Clears Key Hurdle,* The Wall Street Journal (January 9, 2009) available at
http://online.wsj.com/article/SB123144562914865337.html?mod=todays_us_page_one .
FDIC estimate of 2.2 million borrowers benefitting from its streamlined loan modification plans and state proportion of 3Q 2008 seriously delinquent loans as reported in 3Q 2008 MBA National Delinquency Survey; See *FDIC Loss Sharing Proposal to Promote Affordable Loan Modifications*, Federal Deposit Insurance Corporation (November 20, 2008) available at http://www.fdic.gov/consumers/loans/loanmod/.

[27] Court-supervised modification benefit estimated based on state proportion of 3Q 2008 foreclosure inventory as reported in MBA 3Q 2008 National Delinquency Survey and Moody's Economy.com projected reduction on foreclosures due to court-supervised modifications (800,000). Loan modification benefit based on FDIC estimate of 2.2 million borrowers benefitting from its streamlined loan modification plans and state proportion of 3Q 2008 seriously delinquent loans as reported in 3Q 2008 MBA National Delinquency Survey; See note 10 for sources.