TD Bank Financial Group

TD Economics
Observation
August 4, 2009

IS THERE EVIDENCE THAT OBAMA'S LOAN MODIFICATION PROGRAM IS WORKING?

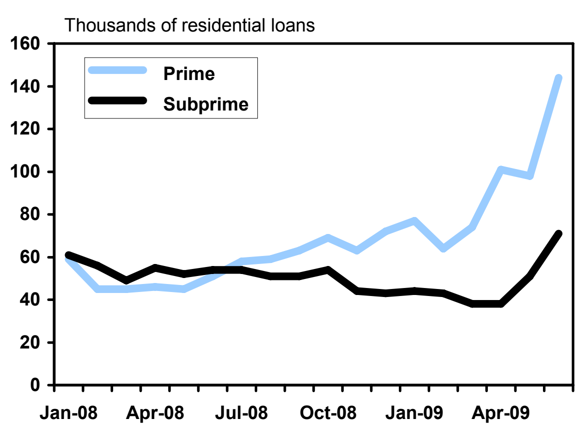
HIGHLIGHTS

- **Although it is still early days with HAMP, the initial data is encouraging and we believe it will help put a floor under prices. State data suggest HAMP could be particularly helpful for vulnerable states, like Florida.**
- **If homeowners successfully meet the 3-month trial period for loan modification, we should see a jump in completed modified loans in the July-September data.**
- **One nagging concern is that the upward trend in mortgage rates could stifle incentives to modify loans or prevent a meaningful decrease in payments -- leading to higher re-default rates, thus making it harder to stop the cycle of foreclosures and falling prices.**

There was much fanfare over President Obama's "Making Home Affordable" program announced in mid-February, which was projected to help between 7 and 9 million American homeowners. The two-prong approach was supposed to facilitate the refinancing of existing mortgages provided that the homeowner had a good payment history and the loan-to-value ratio didn't exceed 105%. For those outside this threshold and currently delinquent or considered to be at risk of default, the Home Affordable Modification Program (HAMP) was designed to restructure the borrower's mortgage payments down to 38% of their monthly income, with the government then providing the subsidy to lower that ratio further to 31%.

This report is an early check-up on the effectiveness of the modification program. Although President Obama announced the plan in February, it took until April to work out the details and enlist servicers to opt into the program.

Formal Repayment Plans Initiated



Source: HOPE NOW

In mid-April, the administration announced that 6 firms had signed agreements to participate in the modification program (including large lenders like Wells Fargo, Citi, and JPMorgan Chase), and by mid-June that number had risen to 15, representing roughly 75% of first mortgages nationwide. With the initiative being relatively new, only April-June data on loan modifications capture the impact of HAMP. A small sample indeed, but some interesting observations still fall out of the data.

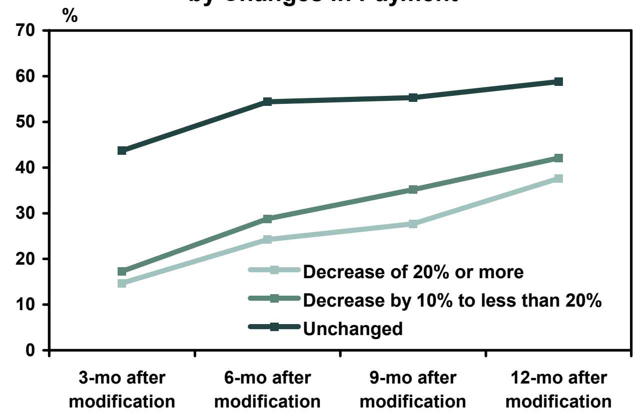
First, June data show a decrease in the number of modifications completed, with the three-month rate of change down 14%. Does this mean the program is a dud? No, because modifications under HAMP require the completion of a three month trial period before the loan can be recorded as officially "modified". In the interim, the altered loan is registered as being part of an initiated repayment plan. In this regard, HAMP looks to have found success, as initiated repayment plans jumped in June, with the 3-month trend rising by 48%. If homeowners successfully meet their payments during the trial period, we should see a jump in completed modifications in the July-September data.

Second, state data for the second quarter indicate that homeowners were clamoring for mortgage modifications and repayment schedules, particularly in the states most exposed to the housing collapse. Florida, Nevada and Arizona saw a jump in initiated repayment plans, so much so that data for the second quarter showed nearly a doubling in loan requests over the previous quarter. In the case of Florida, the April to June pace in repayment plans was up by 81% in the quarter, resulting in an increase of 101% on a year-over-year basis.

Of course, just because a payment plan is initiated and in the trial period, doesn't mean it will succeed in the long run. Re-default rates have been high on past modified loans. The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) indicated that half of the loans modified in the first half of last year were back into default position within 9-12 months. Even loan modifications that led to a decrease in monthly payments of 20% or more still had a re-default rate of 38% one year later. The one silver lining is that although this is a high proportion of re-defaults, it is less than the re-default ratio for homeowners where the payments were left unchanged or increased.[1] And, the OCC/OTS report found that in the first quarter of 2009, there were a greater percentage of modifications that led to reduced monthly payments than in previous quarters. Over half of the modified loans were adjusted to lower monthly payments and about 30% saw payment decreases of 20% or more. These results do not include the impact of HAMP, in which the government will subsidize a reduction in mortgage payments to 31% of the homeowner's income. It seems reasonable to believe that the number of modifications leading to lower payments should increase under HAMP, resulting in lower re-default rates than would otherwise be the case.

Although it is still early days with HAMP, the initial data is encouraging and we believe it will ultimately help put a floor under prices, especially in vulnerable states, like Florida. And, the April-June data is likely underestimating the true demand for modifications, since a number of kinks were still being worked out that delayed delivery of trial modification plans by lenders. As the months roll forward, the speed of delivery should improve and with that a greater share of homeowners in need will be able to find shelter under the modification umbrella. The one nagging concern we have is the recent back-up in mortgage rates. The average rate on a 30-year mortgage in April and May was 4.80%, which rose about 50 basis points in June and July. This is still extremely low relative to history, and it would therefore be lower than the initial interest rate agreement set on past mortgages. Our worry is not with the current level of mortgage rates, but rather, if the upward trend continues. If this turns out to be the case, it could certainly stifle incentives to modify loans or prevent a meaningful decrease in payments (i.e. 20% or more), especially since HAMP does not reduce the principal amount of debt owed. This, in turn, would lead to higher re-default rates, thus making it harder to stop the cycle of foreclosures and falling prices.

Redefault Rates on Loans Modified in 2008 by Changes in Payment



Source: Office of Comptroller of the Currency and Office of Thrift Supervision

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Endnotes

1 Payments are increased in cases were it requires capitalization of delinquent interest, fees and advances.