

NCLC Report Solves Puzzle of Loan Servicer Behavior

Foreclosures Cheaper Than Loan Mods

Despite repeated government efforts to encourage loan modification agreements between struggling homeowners and their mortgage servicers, no program has made any real dent in the rate of home foreclosures. In its recent report, *“Why Servicers Foreclose, When They Should Modify, and Other Puzzles of Servicer Behavior,”* NCLC explains why it has been so difficult for struggling homeowners to obtain modification agreements.

The report reveals that mortgage servicers—including many large banks—have found it cheaper to foreclose on homeowners than to offer loan modifications that would benefit homeowners and investors. As a result, many families who might be able to stay in their homes under a loan modification plan are being moved right past that option and on to foreclosure.

“Servicers, unlike investors or homeowners, generally don’t risk losing money on foreclosures,” said the report’s author, Diane Thompson, an attorney at NCLC. “In fact, servicers usually make money on foreclosures,” she said.

Thompson pointed out that mortgage servicers—including many large banks—have found it cheaper to foreclose on homeowners than to offer loan modifications that would benefit homeowners and investors. Unfortunately, a servicer deciding between a foreclosure and a loan modification faces the prospect of near certain loss if the loan is modified, and no penalty, but potential profit, if the home is foreclosed.

Who are these servicers that profit from foreclosures? Servicers are the banks or financial companies that usually collect payments and administer mortgage loans. They play a key role in the current fore-

closure crisis, since original lenders frequently sell loans to investment trusts that rely on servicers to carry out most day-to-day transactions. Homeowners seeking to save their homes by modifying unaffordable loans typically deal with servicers.

The report found that servicers often deny homeowners principal and interest rate reductions because as servicers they find it profitable to offer repayment plans or forbearance agreements that do little to reduce homeowners’ debt burdens.

“Too many of those financial incentives encourage servicers to ignore the interests of homeowners,” said Thompson. “The people who could change the way servicers are doing business—Congress, the Administration, and the Securities and Exchange Commission—and the market participants who set the terms of engagement—credit rating agencies and bond insurers—have failed to provide servicers with the necessary incentives to reduce foreclosures and increase loan modifications.”

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NCLC’s report makes the following recommendations:

- Avoid irresponsible lending through regulation of loan origination
- Mandate loan modifications before a foreclosure
- Fund quality mediation programs
- Provide for principal reductions on existing loans in the Administration’s Home Affordable Modification Program (HAMP) and through bankruptcy reform
- Increase automated and standardized loan modifications for borrowers in default and provide a safety net for borrowers for whom a standardized modification is not affordable or who later default, through no fault of their own, on a loan modification
- Ease accounting rules for modifications to facilitate standardized review, encourage long-term modifications, and enhance servicer recovery of the expenses incurred in performing a modification
- Require more transparency and uniformity in how servicers report loan modifications to investors
- Limit fees charged borrowers in default to reasonable and necessary ones