One of Five Modified Loans Fails in 90 Days

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Mortgages that were modified in the second quarter of 2009, which had a greater proportion of modifications that reduced monthly payments, are re-defaulting at a lower than those modified earlier. But nearly one out of five borrowers is still re-defaulting only three months after the lowered payments took effect.

That's the good and bad news from the latest Mortgage Metrics Report from the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

Lowering payments by reducing both the principal and interest is the strategy behind the Administration's $75 billion Making Home Affordable program. Though the program has completed only 31,000 modifications, the goal has been to reduce re-defaults, which exceeded 50 percent in modifications older than a year.

Modifications on loans held in the servicers' own portfolios continued to perform better after modification than loans serviced for others. This difference may reflect differences in modification programs and additional flexibility to modify terms to achieve greater sustainability.

Reasons for re-defaulting on a modified loan are similar to those causing initial defaults: high unemployment, depressed property values and excessive borrower leverage. However, the report found that re-default rates were lowest for modifications that reduced monthly payments. The data also show that the larger the reduction in monthly payment, the lower the subsequent re-default rate. For servicers and investors, determining the optimal type of modification often requires weighing the reduction in cash flow from loan terms that reduce monthly principal and interest payments, along with the possible costs of delaying foreclosure, against the potential for longer term sustainability of the payments and ultimate repayment.

During the third quarter, servicers implemented more than 4.5 times as many home retention actions as completed home forfeiture actions. For subprime loans, newly initiated home retention actions were 7.3 times the number of completed foreclosures and other home forfeiture actions.

The number of new loan modifications, however, dropped by 7.7 percent to 131,427 during the third quarter of 2009, as servicers continued to focus on initiating trial period plans under HAMP and other proprietary programs. As a result, the number of modifications relative to the number of borrowers either seriously delinquent or in process of foreclosure also declined during the quarter. Modifications decreased across all risk categories, except prime loans. Subprime loans received nearly 34 percent of all new modifications in the quarter, despite representing only 8 percent of all loans in the servicing portfolio. Prime loans constituted about 38 percent of all new modifications in the quarter, but 68 percent of all loans in the servicing portfolio.

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