HOUSING: Federal effort to help homeowners revives risky mortgages

Critics call program to prevent foreclosures 'most exotic loans ever'

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The pitch is strikingly familiar: A home loan deal that offers a five-year "teaser" rate with low monthly payments, but then escalates to sharply higher costs.

No, this isn't a recap of the variable-rate, interest-only loans of the Amazing Aughts that led to record numbers of defaults. It's a description of the Home Affordable Modification Program from the U.S. Treasury Department, a plan that some analysts and real estate agents think is a dangerous repetition of mistakes of the past.

Launched in March by President Barack Obama as part of a broad program to head off foreclosures and shore up the nation's financial system, HAMP pays lenders cash incentives to reduce mortgage payments for struggling homeowners. But the program doesn't reduce the loan amount ---- often leaving borrowers owing far more than their homes are worth ---- and the low rates generally are set to jump again in the future.

"These are the most exotic loans ever!" said Sean O'Toole, a foreclosure data specialist who founded ForeclosureRadar.com.

So far, the president's program has failed to modify a large number of loans. O'Toole and other critics say that's because many homeowners have learned the hard lessons of the nation's housing crash.

Beginning in the late 1990s, mortgage brokers induced homebuyers to take outsized loans by offering multiyear teaser rates with very low monthly costs. The payments jumped at the end of the teaser period, but if the house had accrued enough value, the homeowner could sell at a profit and pay back the loan.

But in 2006 the market began to crash, eventually erasing 40-50 percent of the average home's value in San Diego and Riverside counties, and other markets around the nation.

Easy credit vanished, selling homes became harder, and thousands of owners found themselves unable to keep up with their ballooning loan payments. Defaults and foreclosures leapt, and the ripple effect took down the U.S. economy.

HAMP was implemented by the Treasury Department in an effort to break this cycle and prevent further damage to the financial system.

Meg Reilly, a spokeswoman for the department, said in an e-mail that the program was intended to "provide immediate relief to homeowners who have suffered a recent financial hardship."

Federal cash offered

The program offers $1,000 per year to each borrower, mortgage servicing firm and loan holder for five years as an incentive to lower monthly payments. Qualified borrowers are those who have suffered financial hardship, but still have the income to make payments, if lowered.

Lenders then go through a series of steps to reduce a borrower's monthly payments to 31 percent of their monthly income. First lenders convert variable interest loans into fixed rates. If that doesn't get the payments low enough, they reduce interest rates for five years; if that doesn't work, they extend loans to 40 years. And last, but not least, they will delay payment of principal of the loan, though that balance still has to be paid off later on.

O'Toole thinks staying in a debt that's far higher than a home's value is a bad idea. To him, the HAMP modifications are a worse idea than any of the exotic loans offered by the lending industry during the housing boom.

"For all the crazy things we did back in 2006 ---- we allowed stated income, we allowed these teaser interest rates, we qualified people based on the teaser rate rather than the long-term rate ---- the one thing we never did was make 125-200 percent loan-to-value loans," O'Toole said.

Homeowners are still making payments for assets that have lost a huge amount of value.

Despite recent gains, homes are down from the market's 2006 peak by 40 percent in San Diego County and 50 percent in Riverside County, according to real estate data firm MDA DataQuick. Few analysts think values will recover in just five years.

"It's a five-year teaser rate," said Donna Steward, a mortgage broker who also does loan modifications. "I tell them (clients), in four years and nine months, file bankruptcy, because your house isn't going to get value back."

Thus far, HAMP has only gotten 5.6 percent of 1.1 million applicants into permanent loan modifications.

Borrowers say mortgage servicers are unable to handle the volume, lenders say borrowers can't get the paperwork right, and servicers say investors who hold the loans are slow to make crucial decisions.

Financial wisdom seen

But some analysts think the real reason home loans aren't being modified is that borrowers don't think these modifications are a wise financial decision.

"This is worse than subprime," said Chris Thornberg, an economist with Beacon Economics. "These loan mods aren't going to work, because it relies on the fact that people are dumb and don't understand they're upside down."

But the equity problem is not one the Treasury Department plans to solve.

"The large number of underwater borrowers is a serious policy concern," said Treasury's Reilly. "However, there are no simple solutions, and we have to consider moral hazard and fairness issues. The administration has no major changes planned for addressing negative equity in the HAMP program."

The Mortgage Bankers Association, an industry group, said the loan modifications were essentially a way to buy time.

"By offering a modification, even for just five years, lenders are giving borrowers affordable payments and allowing them time to get back on their feet or sell the property," said spokesman John Mechem in an e-mail.

But maybe because time is what homeowners need, there have been 1.1 million applications to HAMP.

Jeannette Rodriguez is a 74-year-old retiree who bought her house with her husband in 2005. Not long after, her husband was injured on the job and could no longer work, and then a doctor told her to stop being an accountant because of the stress.

They survived for years on disability payments and savings, but when HAMP was created, they tried to get their loan modified. She said it was because they just don't have the energy to move.

"I used to be a workhorse, but not anymore," she said.

In December, Rodriguez was rejected by the program. Now she's two months behind on mortgage payments and taking her case to the Department of Veterans Affairs, which backed her loan.

"During January, I had gradually gotten a cool mad going on," she said. "My anger has given me new energy to go back at it and start it again."

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