CAN LENDERS DO MORE TO HALT FORECLOSURES?

Banks have begun to modify loans for mortgage-holders, but experts say not nearly enough.

By Tom A. Peter | Staff writer of The Christian Science Monitor

from the April 9, 2008 edition

When Eddie Zepeda bought his house in a San Diego suburb four years ago, it was worth $440,000. Today it's valued at $365,000, even after $32,000 of home improvements. To make matters worse, he's been paying an extra $700 a month ever since his mortgage rate reset two years ago.

He has tried to adjust, but a second job couldn't cover the extra payment. Five banks refused to help him refinance. "They all just told me to hold on tight," he recounts.

That's why Mr. Zepeda contacted You Walk Away, a new and fast-growing website that advises homeowners if foreclosure is their best available option. Zepeda decided it was. "My bank gave me no options," he says.

As foreclosures rise and Congress searches for ways to help homeowners avoid them, a key question is what lenders are doing to ease the crisis that they helped create. Banks and other mortgage-servicing companies point to the rising number of loan modifications and other deals they're striking with at-risk borrowers as evidence that they're tackling the problem. Critics from homeownership advocates to Federal Reserve Chairman Ben Bernanke say they can do more. Some in Congress want to pass laws that would allow bankruptcy judges to force lenders to do more, though it's not part of the current bipartisan Senate bill.

At the heart of the debate is the insidious effect of foreclosures. When they happen, homeowners lose their homes and what they've invested in them. Lenders lose, by one estimate, half the value of the entire loan by the time they've resold the property. If foreclosures proliferate, entire neighborhoods lose as housing values drop.

In 2007, there were 509,000 foreclosures completed, according to Hope Now, a cooperative program of the US government, counselors, investors, and lenders. With the number at an all-time high, banks and other mortgage lenders have begun to look for other solutions. New York-based financial giant Citigroup reports that its refinance and loan-modification deals outnumber foreclosures completed by 5 to 1. Nationwide, the number of loan modifications nearly tripled between the first and fourth quarters of last year, according to Hope Now.

Of course, there's only so much lenders can do. Some homeowners are so far in debt that foreclosure is the only realistic answer. In other cases, lenders worry that if they restructure a loan and home prices fall further, they might have to write down the loan value even more, Mr. Bernanke said in a speech to community bankers last month. Even if a lender wanted to modify loans, many mortgages have been bundled and sold to investors, some of whom might sue if a lender accepted a lower return.

"At this point, the lenders don't have the authority and the capacity to make loans more affordable," says David Petrovich, executive director of the Society for the Preservation of Continued Homeownership in Oakhurst, N.J.

Still, mortgage lenders can do more, critics say. "Yes, there's good work going on. Yes, [lenders] are being innovative, but it's not at the kind of scale that perhaps needs to happen," says Marietta Rodriguez, director of national homeownership programs for NeighborWorks America, a nonprofit organization created by Congress to provide foreclosure counseling, among other services.

Lenders' current efforts take place on a superficial level, argues Bruce Marks, CEO of the Neighborhood Assistance Corporation of America (NACA) in Boston, who has worked with many banks to stop foreclosures by restructuring home loans on a case-by-case basis.

Although some banks offer refinance options, most of those plans were meant to address foreclosure situations before the mortgage meltdown, he says. "In this new scenario, they've got to change everything they've done in the past 25 years."

For example, banks in the past often helped troubled borrowers by giving them more time to pay off the loan amount. What's needed now is a full-fledged restructuring of faulty loans, which includes either a reduction in the value of the loan or in the interest rate associated with the loan. In his experience, he says, this happens only when groups like NACA apply pressure.

Even Bernanke has called on lenders to do more to help borrowers. "Reducing the rate of preventable foreclosures would promote economic stability for households, neighborhoods, and the nation as a whole," he said in a speech in Orlando, Fla., last month. "Although lenders and servicers have scaled up their efforts and adopted a wider variety of loss-mitigation techniques, more can, and should, be done."

The Senate last week scuttled a proposal that would have given bankruptcy judges the authority to reduce interest rates or the principal for troubled home loans.

In the meantime, companies like You Walk Away are flourishing. The three-month-old venture has helped more than 500 people in at least 10 states and plans to quadruple its staff within a month.

The website has drawn criticism that it advocates foreclosure, although cofounder Jon Maddux says the company turns away many people who haven't explored all their options.

"We thought this is definitely going to have some controversy to it," he says. "But we felt there were enough homeowners out there who could use the service that it was worthwhile."