

U.S. Structured Finance Newsletter

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MODIFICATION PERFORMANCE

In December, the U.S. Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) jointly released their *Mortgage Metrics Report*¹ for the third quarter of 2009. According to the report, mortgage performance continued to decline as a result of ongoing adverse economic conditions including rising unemployment and loss in home values. The percentage of current and performing mortgages fell to 87.2% of the servicing portfolio. Seriously delinquent mortgages—loans 60 or more days past due and loans to delinquent bankrupt borrowers—rose to 6.2% of the servicing portfolio. Foreclosures in process increased to 3.2%, while new foreclosure actions remained steady for the third consecutive quarter at 369,209. Of particular note, delinquencies among prime mortgages, the largest category of mortgages, continued to climb. The percentage of prime mortgages that were seriously delinquent in the third quarter was 3.6%, up 19.6% from the second quarter and more than double the percentage of a year ago.

Large national banks and thrifts implemented more than 2.4 million loan modifications, trial period plans, or payment plans between January 1, 2008, and September 30, 2009, including actions taken under the Administration's "Home Affordable Modification Program" (HAMP). During third quarter 2009, servicers continued to increase home retention programs—loan modifications, trial period plans, and payment plans—to assist troubled homeowners and limit potential losses to banks and investors by avoiding preventable foreclosures. More specifically, servicers implemented 680,153 new home retention actions, up 68.7% from the previous quarter. The number of loan modifications declined for the second consecutive quarter as servicers emphasized the origination of trial period plans under HAMP and other proprietary servicer programs.

Despite growth in the number of modifications, modified loans continue to re-default at high rates. Measuring re-default as 60 or more days delinquent or in foreclosure, more than half of all modified loans re-defaulted within six months of modification.

Early indicators suggest more recent vintages with a higher percentage of modifications that reduce monthly payments are performing better than older vintages. More than 80% of all loan modifications implemented in the third quarter reduced monthly principal and interest payments for the borrower. Modified terms were primarily interest rate reductions and term extensions. Modifications with principal reductions increased to 13% of all modifications, up from 10% in the second quarter and 3% in the first quarter.

The 50% re-default rate on modifications continues to be staggering given the income verifications and trial modifications being done by many servicers. As a result, DBRS expects modifications that forgive mortgage debt will likely become the preferred loss mitigation strategy for many servicers during 2010. DBRS also believes that, similar to last year, we are going to see the U.S. government calling for large-scale loan modifications in 2010. DBRS will continue to monitor the industry for its use of modifications as well as its efforts to improve recidivism rates and minimize losses.

For questions or comments, please contact Kathleen Tillwitz at ktillwitz@dbrs.com.

1. http://www.ots.treas.gov/?p=PressReleases&ContentRecord_id=a3dc3ae9-1e0b-8562-eb2a-64c2fc422463.