One factor can make mortgage modifications up to one-third more likely, study finds

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One factor, little-known by borrowers, can play a large role in whether banks are willing to renegotiate mortgages with homeowners who are struggling to meet payments.

Unfortunately, it is a factor that homeowners have no control over.

Researchers found that mortgages owned by lenders were 26 to 36 percent more likely to be renegotiated than very similar mortgages that the original lenders sold to other companies, which turned them into securities.

"Homeowners don't have a say in whether their bank sells their mortgage or not, but that can have a significant impact on whether their loan is re-negotiated," said Itzhak Ben-David, co-author of the study and assistant professor of finance at Ohio State University's Fisher College of Business.

"From the homeowners' perspective, whether their mortgage is traded among investors is completely outside of their control."

Other co-authors of the study are Sumit Agarwal, Gene Amromin, and Douglas Evanoff from the Chicago Federal Reserve Bank, and Souphala Chomsisengphet from the Office of the Comptroller of the Currency.

The research was accepted to the *Journal of Financial Economics* and will be published in a future print edition.

When people get mortgages from lenders such as banks, these lenders can keep the mortgages themselves, or they can sell them to a company like Goldman Sachs, who bundles many thousands of mortgages together into one security offering. They then offer shares of this security to investors.

The lender you got the mortgage from may still "service" the loan – meaning it will collect your payments and deal with your paperwork – but it doesn't actually own your mortgage any more.

"You may not even know that your mortgage has been sold, but it could have real effects on you if you ever become delinquent in your payments," Ben-David said.

Other studies have looked at whether securitization of mortgages affects renegotiations, and have shown conflicting results. But these other studies did not have direct data on renegotiations between lenders and homeowners, so their results may not be as robust as this new study.

By contrast, Ben-David and his colleagues evaluated data on more than 34 million mortgages, making up about 64 percent of all U.S. residential mortgages. This unique dataset includes detailed information on mortgages from 19 different servicing companies owned by 10 large banks. These servicing entities have control over whether mortgages are renegotiated, regardless of their ultimate corporate ownership, Ben-David said.

The dataset comes from two federal agencies: the U.S. Office of the Comptroller of the Currency and the Office of Thrift Supervision.

The researchers focused their attention on the nearly 1.6 million mortgages that were "in trouble" – more than 60 days past due -- in 2008 and the first two quarters of 2009.

The data showed that, at least in 2008 and early 2009, the servicers were not taking quick action against delinquent homeowners, Ben-David said. Six months after the mortgages were listed "in trouble," nearly half had no action taken against them by their mortgage servicers.

Even after a year, servicers had taken no action against about one-quarter of all delinquent homeowners.

"Part of the reason may be that the whole system was congested," Ben-David said. "There were not enough lawyers to handle all of these delinquent loans. Or, perhaps some borrowers self-cured and became current."

About half of the in-trouble mortgages had been foreclosed or were in the foreclosure process after a year. The remaining one quarter was in some type of modification process, he said.

The most common type of modification was a reduction or freezing of the interest rate, results showed.

While only about a quarter of the troubled loans in the study underwent modification, the most striking result was how bank-held loans were 26 to 36 percent more likely to be renegotiated than comparable securitized mortgages.

"This is a very significant economic effect," Ben-David said.

The results were similar no matter the quality of the loan. In other words, borrowers with the best credit scores suffered as much as those with lower scores.

The researchers also looked at what happened to borrowers who did get modifications of their loans.

The results showed that borrowers whose loans were owned by banks actually got tougher terms – for example, they paid higher interest rates after modification than similar borrowers whose loans were in securities.

Still, bank-held loans had about a 9 percent lower default rate after modification than did similar securitized loans.

"That's likely due to the fact that servicers have better information about borrowers whose loans they own directly," Ben-David said.

"The bank knows these borrowers better, so even if they give less concessions they still have better outcomes. They know exactly how much they have to give."

But why are borrowers less likely to get loan modifications if their mortgages are held in securities?

Ben-David said it probably has to do with the added costs involved when the company that services the loan is different from the owner of the loan.

"There are coordination issues between the servicer and owner, as well as the fact that servicers may not have the financial incentive to renegotiate because they don't own the loan," he said.

On an individual level, there's not much one can do to improve your chances of getting a modification, since borrowers don't have control over whether their mortgage is securitized and can't even find out if it has been securitized, according to Ben-David.

From a policy perspective, the federal government had the right idea with its Home Affordable Modification Program, which was designed to help struggling homeowners, he said.

"In retrospect, we know HAMP has not worked well because it wasn't implemented properly. But the economic idea was sound – reduce the servicers' transaction costs so they have an incentive to modify loans," Ben-David said.

Provided by The Ohio State University

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