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A Mortgage Nightmare’s Happy Ending

By GRETCHEN MORGENSON

TWO and a half years ago, Robert and Amy Ahleman, a construction contractor and a financial services employee, were mired in a mortgage nightmare. After missing just one loan payment on their modest, well-kept bungalow in Bensalem, Pa., the couple began receiving notices from their lender. Default fees and eviction threats followed.

As the amounts they owed ballooned because of mounting late fees and other dubious charges, their lender refused to take their payments, claiming they were insufficient — which put the Ahlemans even further behind.

The couple soon realized that filing for bankruptcy was the only way to save their home. At the time, the Ahlemans had two mortgages, one for just under $200,000 and a second for $50,000, and the debt was smothering them.

Today, however, the Ahlemans have a happier story to tell. Not only did they survive their harrowing experience with their home intact, but they say they have emerged happier and thriftier for it.

“Given how much we love the house and our neighborhood, being able to go through that and get out of it makes you look at life totally different,” says Ms. Ahleman, 33. “We can wake up every morning now and not worry about our house being ripped out from underneath us.”

Back in July 2008, when the Ahlemans' troubles were first detailed in a front-page article in The New York Times, their experience was less common than it is today. Since then, of course, millions of average Americans have been sucked into a foreclosure maelstrom that is ruining their finances and their lives.

This disaster has been accompanied by a still-unsettled debate about how best to stem the foreclosure crisis. When the federal government first stepped in to shore up the economy in 2008, it chose to buttress Wall Street and the banking system with hundreds of billions of dollars in taxpayer bailouts while largely leaving homeowners on their own.

Now that the foreclosure mess continues to hamstring the economy and has upset political expectations, policy makers have focused more closely on it. But a divide remains: Should homeowners simply be foreclosed upon en masse, or should banks work with them to modify mortgages and reduce the loans to levels that homeowners can manage?

The Ahlemans can attest to the fact that a modification, when properly engineered, can offer a less financially painful solution for everyone involved in a potential foreclosure. Yet while the couple's default survival tale is uplifting, it's hardly the norm. The terms they received on their loan modification are rarely offered to troubled borrowers today, and so their journey — and their escape from the possible consequences of a foreclosure — remain unusual.

Some analysts and leading economists have cited a failure by banks to provide loan modifications as a signal reason that the foreclosure crisis continues to drag on so ruinously, years after it began. Each month, roughly 250,000 new foreclosures are started, while 100,000 are completed, according to a recent report by the Congressional Oversight Panel, which was created in 2008 to monitor financial markets and those who regulate them.

Figures like these have a huge effect on almost everyone in the country, experts say. Foreclosures blight neighborhoods, put financial pressure on families and drive down local real estate values.

Investors who hold the loans in securitization trusts are also hurt by foreclosures, because recoveries on these properties are low. And consumers, made more cautious by a crippled housing market, spend less freely, curbing the economy's growth.

SOME are prospering from foreclosures, particularly loan servicers that administer mortgages for banks and investors who own the underlying properties. As the report from the Congressional Oversight Panel noted, loan servicers can profit significantly by pushing borrowers into foreclosure. It gives the servicers more opportunities to keep charging lucrative fees and little incentive to seek a modification.

Another obstacle to loan modifications arises if imperiled borrowers have second liens, like home equity loans, on their properties. These liens are often held by lenders who are also servicers on the first mortgage. They, too, have little interest in seeing any modification because it would harm the value of their holdings and reduce their income from fees.

Because of these realities, the Home Affordable Modification Program of the Treasury has been largely ineffective when it comes to helping borrowers get loan modifications from their banks, according to the Congressional panel.

As of mid-December, HAMP had processed almost 520,000 permanent loan modifications. The panel estimated that by the time the program is finished, it will have prevented only 700,000 foreclosures over all — quite a contrast to the three million to four million modifications that the Treasury anticipated when it rolled out its plan. Up to 13 million foreclosures are expected to have occurred by 2012, the panel said.

Tim Massad, acting assistant Treasury secretary for financial stability, attributed the program's results to three things: "The eligibility pool is smaller than we originally thought, and it has been much more difficult to contact borrowers," he said. "Third, the banks have not executed these programs very well."

Kurt Eggert, a professor at Chapman University School of Law in Orange, Calif., said: "I think it's clear that while HAMP was well-intentioned, it hasn't delivered nearly enough. I think a big part of the problem is that nobody is effectively holding servicers' feet to the fire to say, 'Where are the loan mods that you should be delivering that help both borrowers and investors?' "

IN late 2008, a little more than a year after they filed for bankruptcy to protect their home, the Ahlemans received a letter notifying them that their loan was being transferred to a new lender and loan servicer. The company that they would now be dealing with was Litton Loan Servicing, a unit of Goldman Sachs.

Ms. Ahleman said she immediately began pestering Litton for a loan modification.

"I harassed and harassed Litton," she recalls. "We had to submit the paperwork right when our loan was transferred. We didn't hear anything through January and February. I would call them hysterical, crying."

After months of no progress, in the spring of 2009, a reporter called Litton to ask why the Ahlemans' loan modification was stalled. Litton responded quickly and later made the couple a compelling offer: It said it would cut the interest rate on their first mortgage from a variable rate of 9.3 percent to a fixed rate of 4.59 percent. Litton also offered to waive $38,332 in arrears on their loan, which included late fees and legal costs that had accumulated while the loan was in default.

Separately, Banco Popular, the bank that owned the $50,000 second mortgage on the Ahlemans' property — which carried a whopping interest rate of 12 percent — wrote it off entirely. This eliminated the couple's obligation to pay the debt, which had grown to $62,000, including fees and other charges. (The couple paid taxes on the forgiven mortgage.)

Under the terms of the new loan, the Ahlemans' mortgage obligations dropped from almost $250,000 to roughly $198,000. Their monthly payment fell from $1,959 to $1,376.

The Ahlemans say their loan deal gave them a life-changing second chance. Since they received it in June 2009, they have made their payments on time; they emerged from bankruptcy a year ago.

With work busy for both of them, they have been able to put money away in case they hit another rough spot.

“We like to have one or two mortgage payments in a savings account so that money is there to fall back on if we do have a bad month,” Ms. Ahleman says. “From going through that whole experience, we became very frugal. Every now and then, we’ll go out to dinner, but we don’t splurge or go on shopping sprees.”

The Ahlemans hold no credit cards, except for the one that Mr. Ahleman, 36, uses for his contracting business. They cut up their credit cards back in 2008, when they filed for bankruptcy, paying them off under a court-approved plan.

“If we can’t pay cash for it, we don’t buy it,” Ms. Ahleman says. “That’s one thing we learned. Credit cards will get you in trouble. I will never allow myself to get in that position again, regardless of what I have to do.”

For policy makers interested in designing loan modification programs that actually work, the Ahlemans’ story may be instructive. Because most banks refuse to provide principal write-downs on troubled loans, the kind of modification the couple received is the exception rather than the rule across America today.

Most loan modifications, if they can be wrangled out of lenders at all, reduce the interest rate only slightly and tack onto the mortgage all the late fees, legal fees and other questionable costs that have accrued in the foreclosure process — simply adding to the debt that borrowers must repay.

“While focusing on the safety and soundness of banking institutions, regulators have focused too little on protecting borrowers from abusive practices,” says Mr. Eggert, the law professor.

The Congressional Oversight Panel noted the possibility that conflicts of interest among loan servicers were preventing loan modifications from being struck. Representative Brad Miller, a Democrat from

North Carolina, is advocating that loan servicers be separated from the institutions that hold a borrower's loan, in order to eliminate such potential conflicts. He is also urging regulators to create strict criteria that loan servicers will have to follow when working on modifications.

Mr. Miller is circulating a letter among his colleagues that outlines his suggestions. It is addressed to top officials at six federal agencies or regulators: the Federal Reserve, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Securities and Exchange Commission, the Office of the Comptroller of the Currency and the United States Treasury.

For the loan modification criteria, Mr. Miller pointed to the rules set out by Farmer Mac, a government-sponsored enterprise that finances farm loans. Those rules include requirements about who qualifies for a change in the terms of their mortgage, and a calculation of the likely loss that a foreclosure might create.

"The criteria are designed to lead to a sensible modification that the farmer can sustain," Mr. Miller says, "and it protects the investor as well by getting people into mortgages rather than undergoing the horrific expense of foreclosure."

Mr. Miller also aims to end affiliations between servicers and banks, which he said were proving to be a genuine impediment to loan modifications.

"Having a servicer be affiliated with a big bank does not really have any offsetting advantage," he says. "It creates conflicts of interest, it puts the servicer in the position of controlling information and allows it to protect itself at the expense of homeowners and investors."

THE F.D.I.C. has proposed a set of loan servicer requirements that, among other things, would try to eliminate conflicts of interest.

Under its proposal, a servicer would have to disclose an ownership interest that it or an affiliate had in a loan secured by the same property on which another mortgage was outstanding. The servicer would also have to establish a process to address any second lien that it might own where the first mortgage is seriously delinquent.

Mr. Eggert said a national set of servicing standards would be a crucial step toward putting consumers and investors onto a level playing field with loan servicers.

"At the recent Senate testimony where all the federal agencies came forward and testified about servicer problems, it was telling that they didn't talk about what they have already done about it," he says. "Instead, they talked about the investigations they are conducting that they hoped would inform them on what to do next. How many years are we into this crisis? We are long past the point of where we should be investigating to see what's happening."

For the Ahlemans, at least, their flirtation with financial disaster — and the modification that helped them survive — has made them appreciate life more.

"We're just really, really happy all the time," says Ms. Ahleman. "I used to say to myself, 'When I wake up in the morning, I just want to feel how people who are comfortable in life feel.' And now we have the ability to do that. It can be done."

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