THE WALL STREET JOURNAL.
WSJ.com

BUSINESS | MARCH 25, 2010

Bank Launches Big Plan to Cut Mortgage Debt

By JAMES R. HAGERTY And NICK TIMIRAOS

Under pressure by Massachusetts prosecutors, Bank of America Corp. said Wednesday it would reduce mortgage-loan balances as much as 30% for thousands of troubled borrowers, in what could presage a wider government effort to encourage banks to offer debt reduction to ease the mortgage crisis.

The plan is one of the boldest moves yet to address the plight of millions of U.S. homeowners who are "under water," owing more on their homes than they're worth. It could make it easier for the Obama administration to move in a similar direction with its existing loan-modification program, although senior government officials and many bankers remain very wary of offering to cut loan balances as the main way of helping distressed borrowers.

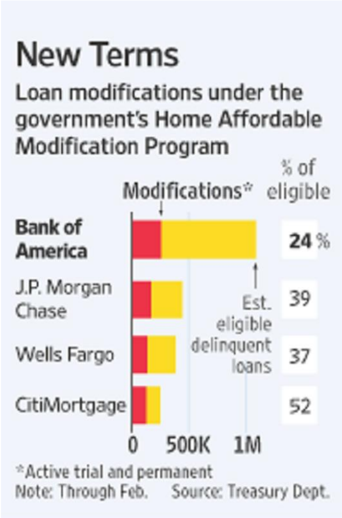
So far, most modifications, including those under the government-subsidized Home Affordable Modification Program, involve reducing interest rates. Some also extend terms to 40 years, to shrink monthly payments.

But banks are finding that some borrowers aren't willing to keep making even reduced payments, believing they have little hope of ever having equity in their homes and might be better off renting, and perhaps buying a less-expensive home later.

"Severely under-water homeowners are reluctant to accept a solution that does not offer some reduction in principal," said Barbara Desoer, president of Bank of America Home Loans. "The whole purpose of the program is to get more customers to return phone calls" and make payments for trial modifications so workouts can be made permanent, she added.

The Obama administration is discussing with banks how to adjust its existing loan-modification program to encourage forgiveness of principal, people familiar with the matter say. An official declined to discuss such efforts but said the administration was encouraged by Bank of America's initiative, calling it "consistent with our own housing policy principles."

Howard Glaser, a housing-industry consultant, said, "The fact that private institutions are moving in this direction makes it more palatable for the Obama administration to face criticism from homeowners who think there's unfairness" in reducing principal for only some people.



The action by Bank of America is notable because it is the largest mortgage servicer, collecting loan payments on one of every five home loans in the U.S. At the end of last year, 14.76% of them were at least 30 days past due or in foreclosure, versus an industry average of 12.31%, according to Inside Mortgage Finance.

Some housing advocates were skeptical. Kevin Stein, associate director of the California Reinvestment Coalition, which works on access to credit, said "Everyone, including us, is looking for something positive to point to, but we are concerned this is going to be more P.R. than substance."

The bank's program is limited to Countrywide borrowers whose loan balance is at least 120% of the estimated home value, who are at least 60 days overdue, and who can show that financial hardship makes them unable to meet current payments. The bank estimated that 45,000 customers will qualify for principal reductions averaging more than $60,000.

Only the riskiest loans will be eligible. They include subprime loans; "option adjustable-rate" mortgages entailing minimal payments now but big increases later; and certain loans that have a fixed rate for two years and then adjust annually.

The bank's move is part of an agreement to settle claims over certain high-risk loans made by Countrywide Financial, which the bank acquired in mid-2008. The Massachusetts Attorney General's office, which was negotiating with the bank, said it was prepared to file suit had the agreement not included principal reductions.

Other banks have selectively reduced balances on certain loans. Wells Fargo & Co. said it modified loans for 52,600 borrowers with "option-ARM" loans last year, totaling $2.6 billion in principal write-downs.

Citigroup Inc. reduces principal on a case-by-case basis after other options to address affordability are exhausted, a spokesman said.

Banks and policy makers have long worried that reducing loan balances for some could spur others to default in hopes of a similar deal. Bank of America said it believed it would limit that risk by requiring borrowers to "earn" the lower balances in stages over five years by keeping up on their new, lowered payments. After the third year, the bank could halt principal forgiveness if home values have stabilized enough to provide borrowers with equity.

Last fall, Bank of America slashed more than $200,000 in principal on an option-ARM that Precy Padua used in 2007 to buy a nearly $1 million four-bedroom home in Fairfield, Calif. That modification, which stemmed from a 2008 multi-state Countrywide settlement, lowered her principal balance to $635,000 and provided a 5.5% fixed rate over 40 years.

Ms. Padua said she had stopped making her payments in late 2008, even though the loan wasn't set to adjust to higher payments for years, because the home's value had fallen to around half of the $850,000 she owed.

"We made a mistake," said Ms. Padua, a 61-year-old clinical lab technician. The lower principal balance is a "big help," she said, even though her monthly payments have increased by nearly 40% from the initial low teaser payments, to $3,275. She estimates her home is still under water by $100,000.

Bank of America has come under fire for not doing enough to rework troubled loans. Through February, it had 240,550 borrowers—or 24% of potentially eligible homeowners—in trial or permanent modifications, according to the Treasury Department, lower than most competitors. The bank had completed modifications for 20,666 borrowers, with 22,303 pending.

A bank spokesman said the government's numbers don't accurately reflect the firm's performance.

- **Deal Journal:** What Took Them So Long?
- **Developments:** How BofA's Program Works

—Ruth Simon and Matthias Rieker contributed to this article.

Write to James R. Hagerty at bob.hagerty@wsj.com and Nick Timiraos at nick.timiraos@wsj.com