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Home-Saving Loans Afoot

By JAMES R. HAGERTY

Pressure is growing on U.S. banks to ease terms for distressed homeowners on home-equity loans and other second-lien mortgages.

Rep. Barney Frank, chairman of the House Financial Services Committee, last week sent a letter to the four biggest U.S. banks demanding "immediate steps to write down second mortgages." The Massachusetts Democrat sent the letter to the chief executive officers of Bank of America Corp., Citigroup Inc., J.P. Morgan Chase & Co. and Wells Fargo & Co. Meanwhile, the Obama administration is preparing to launch long-planned initiatives aimed at addressing these obstacles.

Rep. Frank said banks' reluctance to write down second mortgages is blocking efforts to reduce the first-lien mortgage balances of many borrowers who owe far more on their loans than the current values of their homes. Because such "underwater" borrowers often feel little incentive to keep paying, "homeowners are increasingly deciding to walk away and thus foreclosures continue to mount," he said.

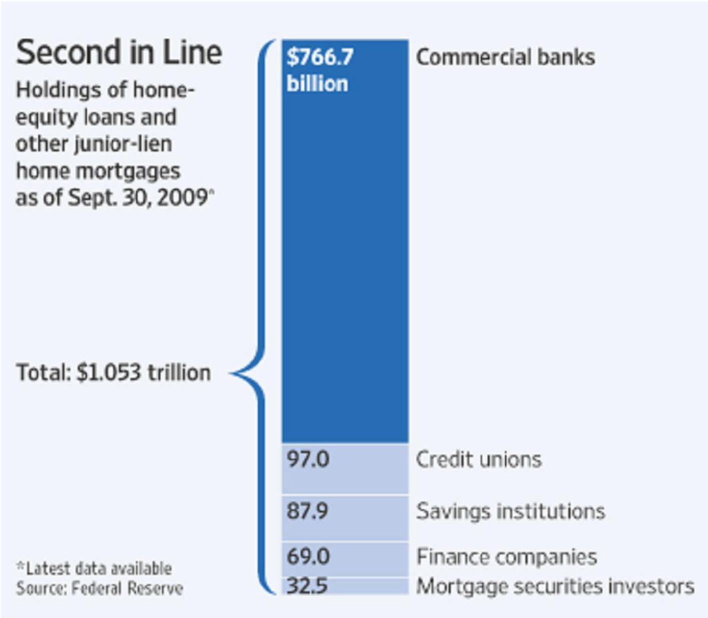
Many second liens have little value because of the plunge in home prices, Rep. Frank wrote, adding: "Yet because accounting rules allow holders of these seconds to carry the loans at artificially high values, many refuse to acknowledge the losses and write down the loans."

A Bank of America spokesman said that bank is "committed to working with all interested parties to develop additional solutions to help homeowners modify first and second mortgages." A J.P. Morgan spokesman declined to comment. Representatives of Citigroup and Wells provided no immediate comment.

Lack of cooperation from holders of second liens also can block short sales, in which the first-lien lender agrees to allow the home to be sold for less than the loan balance due to avoid a foreclosure. If the second-lien holder continues to press its claim against the borrower, the sale can fall through. The ensuing foreclosure is likely to be more costly for all the parties than a short sale would have been.

Under an Obama administration program due to begin in the next few weeks, borrowers who get reduced payments on their first-lien mortgage through the administration's Home Affordable Modification Program automatically would get a break on their second-lien mortgage. Bank of America Corp. already has agreed to take part in this program, and other big lenders are expected to follow suit.

In April, the administration is due to launch financial incentives to encourage alternatives to foreclosure for people who don't qualify for a loan modification. The alternatives include short sales and so-called deeds in lieu of foreclosure, in which the borrower voluntarily gives up title to the home and often gets cash to help with moving expenses.



Under this Home Affordable Foreclosure Alternatives program, holders of second-lien mortgages would be eligible to be paid 3% of the unpaid loan balance, up to a maximum of $3,000, for giving up all claims in the event of a short sale. Unclear is how many second-lien holders would participate.

Most first-lien home loans are held by the government-controlled mortgage companies Fannie Mae and Freddie Mac or by other investors in mortgage securities. By contrast, banks hold most of the seconds and other junior-lien mortgages. About $1.05 trillion of junior-lien home mortgages were outstanding as of Sept. 30, according to the Federal Reserve. Of those, $766.7 billion were held by commercial banks; most of the rest were owned by savings banks and credit unions.

If banks are forced to write down or write off large amounts of those second mortgages, many would suffer major dents in their capital. Laurie Goodman, a senior managing director at mortgage-bond trader Amherst Securities Group LP, said regulators may need to allow banks to recognize losses on second-lien loans over an extended period to avert a disastrous immediate hit to their capital.

One reason banks are reluctant to write off second mortgages is that some may still have value even after a foreclosure. Though the foreclosure wipes out the lien on the home, the consumer still has a legal obligation to repay the second mortgage debt in some cases. If the borrower has no significant assets remaining, banks generally don't bother trying to collect that debt. But they do retain that option and some say they will pursue it in cases where the borrower has significant assets or income, or may later have the ability to repay.

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