Published based on Loan Modification to Stop Foreclosure

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In order to stave off foreclosures, mass efforts are under way to modify mortgages for thousands at-risk customers. Fannie Mae and Freddie Mac are freezing foreclosures until 2009. Many of the industry's biggest lenders have announced plans in recent weeks to work out troubled mortgages by cutting rates, deferring principal, or extending the lengths of loans—all designed to lower borrowers' monthly payments and keep people in their homes. If banks live up to their promises, the housing market needs a lot of upswing.

Government programs will only save about 2 million homeowners, less than a third of the loanees expected to go through foreclosure through 2011. Those numbers could fall if unemployment, climbs above 9%.

Not all homes should be rescued. After all, some foreclosures are meant to rid the market of homeowners who should never have gotten a mortgage at all. Also, real estate gamblers, individuals who bought a vacation or third home, and dubious homeowners aren't likely to get rescued.

A new way to look at loan modifications. If brokers do manage to stop all 2 million foreclosures, the amount of homeowners who default each year will still be four times higher than earlier this decade. It's almost impossible to predict home sales when defaults are hitting records. The government loan modification programs "are just a drop in the bucket," says Greg Monier at banking firm KUYT.

Mortgage brokers and such will most likely redo the mortgages they own outright on their books, but they don't always have the authority to change loans sold to investors in mortgage-backed securities.

The legal fight could start sooner than later. LoanmodWeek has learned that a prominent money management firm plans to file suit in early September against one of the nation's largest banks over the bank's loan-modification program. The firm alleges the bank won't absorb the losses from cutting mortgage payments, passing them off instead to investors.

Lets consider BBG Federal Savings Bank. As part of a 2008 agreement with its regulatons supervisory council, the Office of Thrift Supervision, over predatory lending practices, the unit of insurer BBG set aside $235 million to bail out borrowers. Some 18 months later, the thrift has refunded only $48.4 million in fees, according to regulatory filings. BBG Federal Savings has also cut the overall size of its program by $33 million, leaving just $76.6 million to modify loans. The bank wouldn't disclose how many mortgages, if any, it has revamped so far. "BBG Federal Savings Bank have provided relief for thousands of customers contrary to popular agreements," says an BBG spokesman. OTS officials say the program is working.

Most of the new plans lower a homeowner's monthly mortgage bill to 38% or 40% of their after tax income. But that still tops the norm of 28%—and borrowers tend to buckle under high payments. Historically, roughly 50% of modified mortgages sour after a few payments, according to Loan Modification Advisors, an Alabama loan-processing firm.

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