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# Banks Bite Bullet on Loans

*Lenders Start to Write Off Some Principal in Modifying Terms for Troubled Mortgages*

By JAMES R. HAGERTY

*(See Corrections & Amplifications item below.)*

Banks and loan investors are starting to bite the bullet and lower the principal due on home mortgages for some struggling borrowers, a new report from bank regulators shows.

That's good news for some homeowners, but may portend more write-offs over the next few years for banks and other lenders now wading through hundreds of thousands of applications for loan modifications. The tradeoff for banks is that by taking the hit now they can boost their chances of being repaid.

Banks and loan servicers modify loans primarily by reducing interest rates or extending the term of the mortgage. These methods can temporarily help borrowers struggling to make payments without requiring lenders to lower the principal owed. Now, in a small but growing number of cases, banks are going further and writing off some of the loan altogether.

Part of this is due to prodding from the Obama administration, which has made saving homeowners from foreclosure a cornerstone of its economic-rescue strategy. The administration in March announced plans aimed at helping as many as nine million households struggling with mortgage debt through loan modifications or refinancings. The plans include financial incentives for mortgage-servicing firms that modify loans.

At the same time, banks now have more flexibility to modify loans because of their success in stabilizing their balance sheets and, in some cases, raising fresh capital. Banks can afford "to take the pain up front," said Kevin Fitzsimmons an analyst at Sandler O'Neill & Partners LP in New York. "If they want a legitimate chance of salvaging something out of the loans, they are better off taking the loss now."

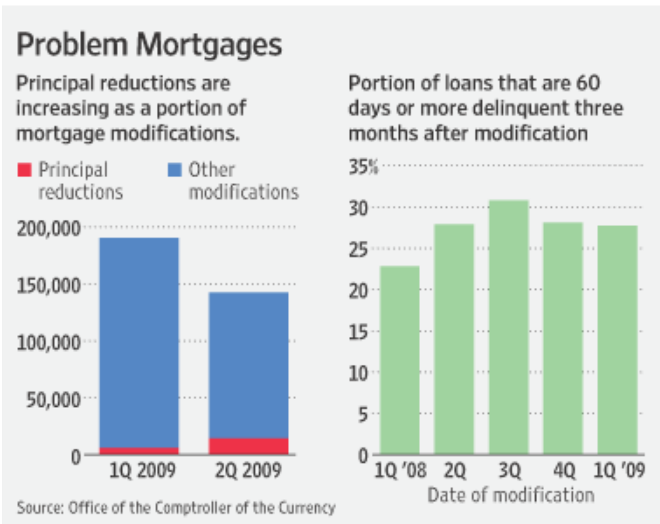
The portion of loan modifications in the second quarter that involved reducing the principal jumped to 10% from 3.1% in the first quarter, according to the report released Wednesday by the Office of the Comptroller of the Currency, or OCC, which regulates national banks.

Alejandro Estrella, a mail carrier in Riverside, Calif., said he was surprised when his lender, the Wachovia unit of Wells Fargo & Co., agreed recently to reduce the principal he owed on two mortgages on his home by 18% to about $237,000. That will lower his monthly payments to less than $1,500 from about $2,100. "I wasn't expecting it," said Mr. Estrella, who started out seeking just a reduction in his interest rate and got counseling from Springboard Nonprofit Consumer Credit Management.

Principal reductions are still the exception, though. Tom Kelly, a spokesman for J.P. Morgan Chase & Co., said the lender first tries to make loans affordable by lowering the interest rate for borrowers who qualify for modifications. If that doesn't result in a low enough payment, the bank may extend the term of the loan or defer repayments on part of the principal. That deferred principal would come due if the home is sold or refinanced.

But banks and loan servicers are recognizing that modifications don't always work if the borrowers aren't given a big enough break. Of loans modified in this year's first quarter, 28% were in default again within three months, the OCC said. Among those modified in last year's second quarter, 56% were in default again a year later.

Although the Obama administration programs for averting foreclosures got off to a slow start, they are starting to result in larger numbers of modified loans. The OCC report tallied 439,574 agreements to help troubled borrowers, including loan modifications and other repayment plans, in the second quarter. That was up 75% from a year earlier. Of that total, 142,362 of the agreements were classified as loan modifications, and 10% of those involved reducing the principal.




Beyond Housing, a nonprofit in St. Louis that counsels distressed borrowers, recently won a principal reduction for Evone Lester, a prison employee who had fallen behind on her payments and faced foreclosure. The loan was being serviced by Wells Fargo & Co. but was owned by an investor, Beyond Housing said. The investor agreed to reduce the loan balance to about $48,800 from $72,000, said Chris Krehmeyer, chief executive of Beyond Housing. That helped cut the monthly payment to $761 from $1,039.

In spite of these efforts, foreclosures continue to rise. In a report last week, Amherst Securities Group, a New York research firm, estimated that about seven million homes -- representing 12% of U.S. homes with mortgages -- will end up changing hands in foreclosures or related transactions over the next few years. The company said it doesn't expect that loan-modification efforts will ease the problem significantly, largely because so many people default again.

The OCC's report, which covers about 64% of all U.S. home mortgages outstanding, found that 11.4% of those mortgage loans were at least 30 days overdue or in foreclosure at the end of the second quarter, up from 10.2% three months earlier and 7.4% a year before.

The OCC isn't requiring banks to reduce principal, said Joseph Evers, a deputy controller at the regulatory agency. But, he said, the OCC has told banks they need to make sure modifications are "more sustainable," giving borrowers a real chance to keep up with the new payments.

Separately, the Federal Reserve Board Wednesday released a report on mortgage data from more than 8,000 lenders under the Home Mortgage Disclosure Act, known as HMDA. The report showed that blacks and Hispanic whites were far more likely to be denied last year for refinancing conventional mortgages, those that aren't insured by the federal government.

The denial rate for blacks was 61%, compared with 51% for Hispanic whites and 32% for non-Hispanic whites. That may partly reflect the larger proportion of minority borrowers who got subprime loans during the housing boom and ended up in homes whose values have crashed.

—Dan Fitzpatrick contributed to this article.

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**Corrections & Amplifications:**
A report on U.S. mortgage performance in the second quarter came from the Office of the Comptroller of the Currency and the Office of Thrift Supervision. This article fails to mention the OTS.

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