

## M Hanson Advisors – Real Estate & Finance

*The Mortgage Pages - May 12<sup>th</sup> 2010*

- **Hope Now Alliance Quarterly Report Confirms “Credit” Has Morphed**
- **Over the Near-to-Mid Term Credit will Morph Again**
- **Modification Purgatory**

*Our mission is to provide our clients a significant edge. This is done by turning the daily, market-moving real estate and mortgage news flow and events into old news by the time it makes headlines. - Mark Hanson*

### Summary

- 1) For a couple of years, as part of our data offering, I have been tracking **Cancelled Foreclosures** knowing one day it may make for an interesting data point. The past couple of quarters have not disappointed me.
- 2) The velocity with which Cancelled Foreclosures (mods and restructurings performed) are occurring has outpaced all Foreclosure stages since Q309 across all loan types making for the appearance that “credit” is improving.
- 3) Further, loan mods and restructurings **stealing from early stage delinquencies and defaults, and foreclosures** -- but still occurring at a slower absolute pace than new delinquencies and defaults are entering the pipe -- have made it so the massive default bubble of eight million resi loans can't deflate unless Foreclosures surge.
- 4) Yesterday the Hope Now Alliance released their Q1 update that correlates perfectly with my real-time data and **makes it doubtful that “credit”, as we have historically measured it, has improved at all.**
- 5) The bank's shift in focus **from a mission of recovery** (working severely defaulted loans) **to a mission of rescue** (working loans further up the delinquency pipe including current loans) -- using their new and improved, mega-robust, legacy loan alchemy platforms across all loan types -- shuffled the deck and changed the natural timing and order of when delinquency and default events occur. But most will still occur.
- 6) This is because mods are nothing more than new, higher leverage loans than ones on which the borrower's are currently experiencing the trouble. **To think that making new, higher-leverage loans to more levered borrowers will somehow turn out better than the toxic legacy loans is flawed.** But when there is no desire to lend -- or true underlying demand for credit relative to the bubble years -- diluting the trillions in bubble-years toxic loans is impossible and this is sadly, the only route.
- 7) Because of the timeline of when the loan mod and restructuring bubble first began to blow in Q3 only **the positive effects of modifications have been felt to date and not the negative re-default effects.** But based upon the six through 18-month trend the leading edge of the re-default wave is upon us now making for a good case that Q110 was as good as it gets for “credit” as we now know it if May and June NOD, Foreclosure, and Cancelled Foreclosure activity continues at the same pace as the past three months.
- 8) As re-defaults do begin to happen in earnest “credit” again will morph, as they drop into various delinquency, default and foreclosure buckets depending upon where they were when they entered *Modification Purgatory*. In fact, **if the loan was already past the NOD stage when the loan was modified and it re-defaults within a year of the NOD, it could be a 30-day late and a Notice-of-Trustee Sale (late stage default) simultaneously.**
- 9) Because of continued, epic volatility in new-era “credit”, **on a go forward basis** real-time Foreclosure stage and Cancelled Foreclosure tracking **at the macro, servicer-specific, and loan and property type level** will be fundamental in establishing when and at what pace credit will begin to worsen again, which it will with modification purgatory never holding as many souls as in April. Luckily, as far as I am aware, we are the only firm that tracks all of these conditions in real-time -- and makes it available to clients -- so there should be no surprises.

**Highlights from the Hope Now Q1 report:**

**1) In Q309 Foreclosure prevention “Solutions” Began to Surge**

The staggering growth in toxic loans aka loan modifications, as kept Foreclosures at bay since q309. Regardless, in March osmosis alone carried Foreclosures to record highs.

To date, we have only felt the positive effects from mods. But **on a go-forward basis**, as re-defaults begin to occur in earnest, a secondary channel of early stage delinquencies, defaults, and foreclosures will come from the mortgage mod bubble few are modeling.

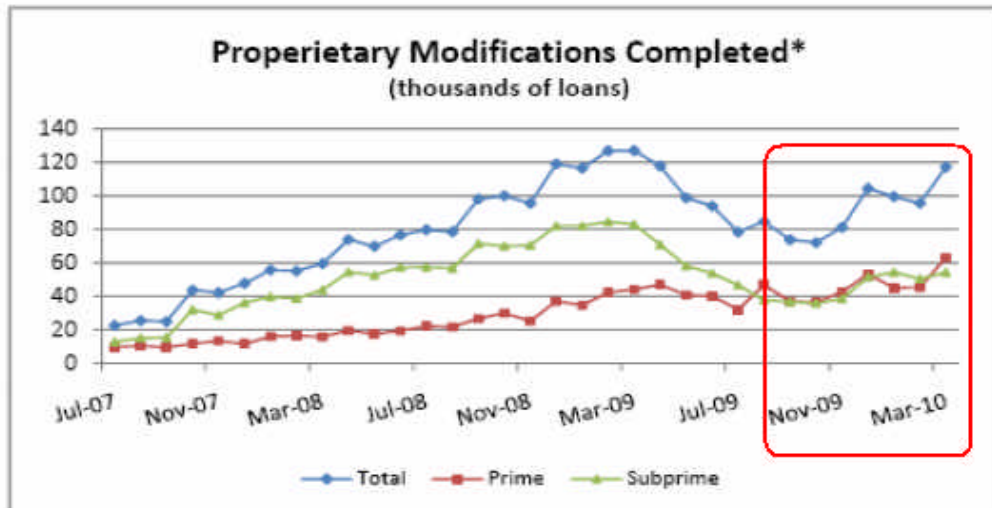


Source: Making Home Affordable and HOPE NOW

\*Total Solutions is comprised of HAMP Permanent and Trial Loans, Proprietary Modifications Completed, Repayment Plans Initiated, Other Retention Plans Completed, Short Sales and Deed-in-Lieu

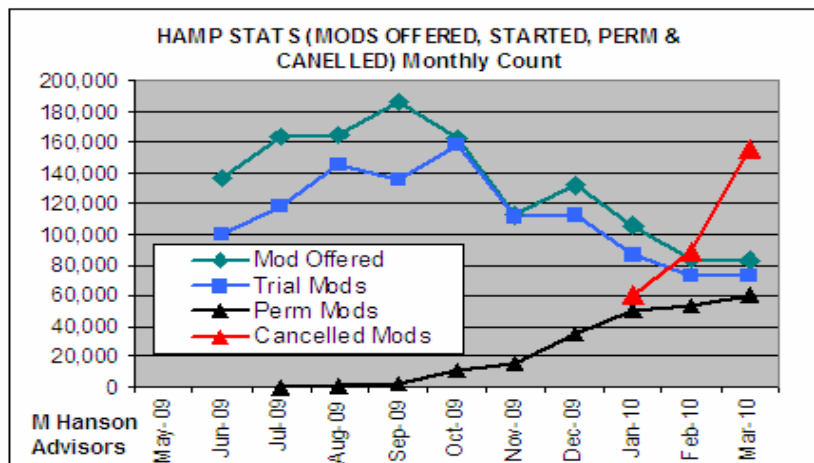
**2) Non-HAMP Mods (Bank Private-Label) Surged Later than Macro**

This is because in q1-q209 servicers had their hands tied with HAMP. As HAMP offers, applications and trial mod began to tumble in q309 as shown in the second chart below, the banks -- **with their new and improved, mega-robust, legacy loan alchemy platforms** -- began to shovel all loans into them continuously moving further up the default and delinquent timeline. In fact, in q3-q409, 60% of all Jumbo mods at WFC and JPM were performed on current loans.



\*Non-HAMP

Beginning in q309, new mod offers and trials began to tumble, which freed up servicer capacity to modify everything in sight, including current loans, which has hidden true “credit” conditions.



#### 4) Real-time Cancelled Foreclosure Correlation

The chart below is of my real-time **Cancelled Foreclosure** data across all property types. As shown here and in the previous Hope Now reports, the **surge in Cancelled Foreclosures -- indicative of loan mods -- began in earnest in Q3**.

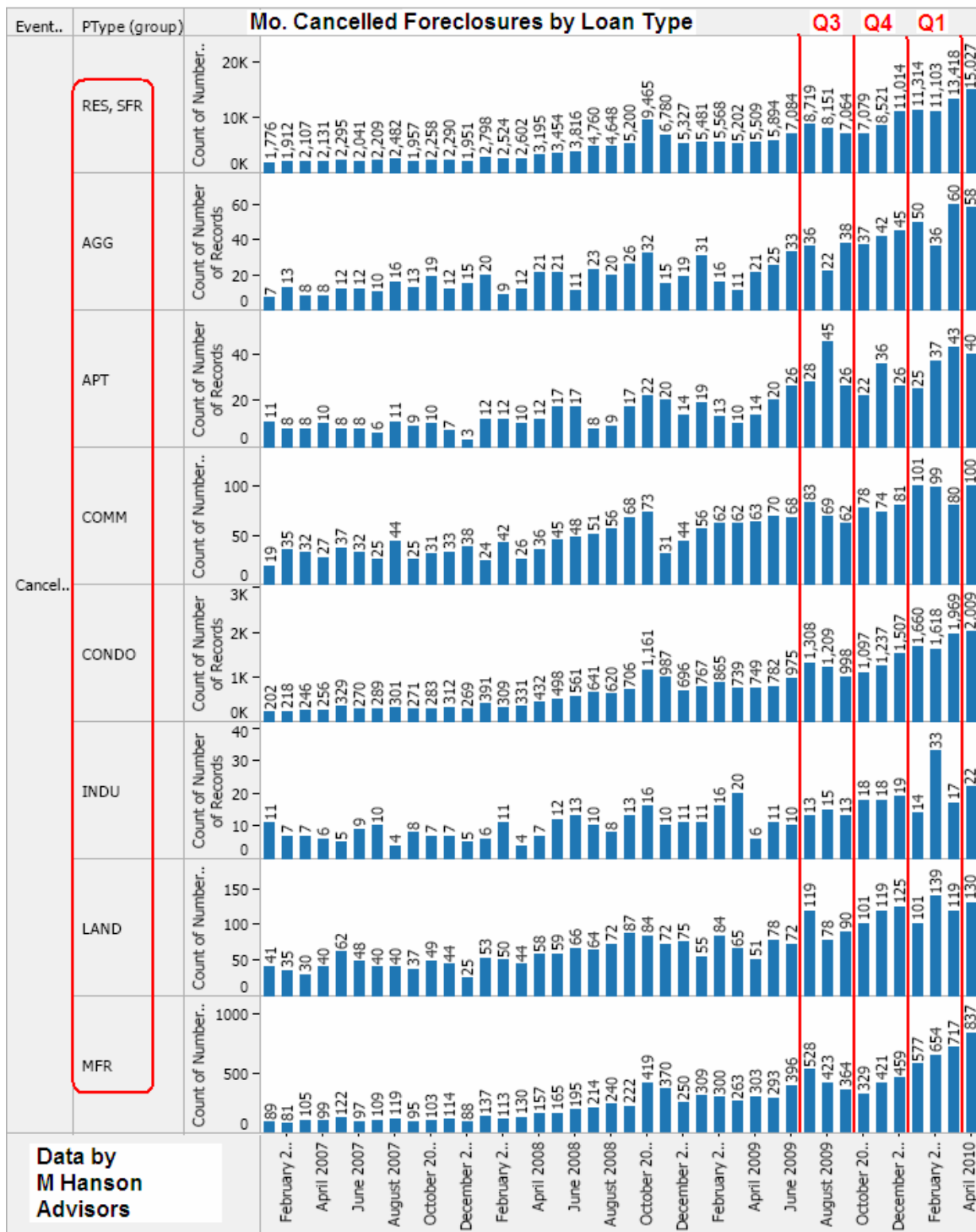
This surge is what has led to hope of “**credit**” getting better and a substantial and premature reduction of loan loss reserves by many banks. Mods have also helped to keep a tremendous amount of housing inventory off of the market -- masking the true supply fundamentals -- until such time the borrower re-defaults, which will happen in most cases.

Because this surge is so new, based upon the average re-default time-line, **to date we have only felt the benefits of mods and not the re-default consequences**, which will produce another completely new channel of defaults and Foreclosures that few are modeling. In fact, the leading re-default edge is upon us right now.

As these loans re-default they will begin the subtly change the Foreclosure metrics that we track daily, as I highlighted in yesterday’s servicer-specific reports, allowing us to identify a worsening of new-era “credit” first.

The data below is a filtered sampling of only top servicers and community banks, therefore, it is not the absolute count that is important here, rather the rate-of-change. When the mod and restructuring surge began across all loan types -- and “credit” began to improve -- is blatantly obvious.

**Cancelled Foreclosures (indicative of loan mod) by Loan Type - Through April 30th**



## 5) The Absolute Numbers as Report by Hope Now

When 1.36 million mortgages in a quarter, of which many are of the most troubled yet many were current and performing at the time but at the edge of delinquency, are essentially put off balance sheet temporarily, it takes little imagination what this does to the delinquency and default stats.

**To think that making new, higher-leverage loans to more levered borrowers will somehow turn out better than the toxic legacy loans is flawed.** But when there is no desire to lend -- or true underlying demand for credit relative to the bubble years -- diluting the trillions in bubble-years toxic loans is impossible and this is sadly, the only route. To think we are anywhere near containment or an end of the default and Foreclosure crisis is a pipe dream.

Data highlights: 1Q 2009 vs. 1Q 2010:

- Total workout solutions increased from 0.71M to 1.36M (+92%)
- Modifications completed increased from 370,440 to 476,190 (+29%)
- Foreclosure starts decreased from 728,780 to 691,020 (-5%)
- 60 days+ delinquency increased from 2.85M to 3.99M (+40%)
- Completed foreclosure sales increased from 201,310 to 291,380 (+45%)

**Best Regards,**  
**Mark Hanson**  
[Mark@MHanson.com](mailto:Mark@MHanson.com)  
[www.MHanson.com](http://www.MHanson.com)

This document is for your private information only. In publishing research, Mark Hanson and M Hanson Advisors are not soliciting any action based upon it. Mark Hanson and M Hanson Advisors publications contain material based upon publicly available information, obtained from sources that we consider reliable. However, Mark Hanson and M Hanson Advisors does not represent that it is accurate and it should not be relied on as such. Opinions expressed are current opinions as of the date appearing on Mark Hanson and M Hanson Advisors publications only. Mark Hanson and M Hanson Advisors are not liable for any loss or damage resulting from the use of its product. Mark Hanson and M Hanson Advisors are Limited Liability Corp registered in CA.



**\*Data for this report provided by M Hanson and Hope Now Alliance**