New HAMP data I received earlier in the month, but just reviewed this weekend, has absolutely convinced me I have been too bullish about the scope and pace of the modification redefault wave cresting right now and it's effects on housing.

1) - HAMP & Private Label Permanent Mods based upon HAMP Guidelines Will Redefault at Much Greater Pace Than I Thought Beginning Now

-Average Loan-to-Value of HAMP Permanent Mods an Unbelievable "More Then 150%"! & Debt-to-Income Ratio's at 64%...a Combination so Risky No Lender Knowingly Offered Anything Close During the Bubble Years

The mortgage modification bubble we are experiencing, which began in earnest with HAMP in q209, but really began to blow in q309, is a strange thing. It seems that when loans are modified -- essentially moved off-balance sheet for a while --everybody forgets they exist, washes their hands, and declares "problem solved". Out of sight, out of mind.

But all this radioactive trash locked away in the cellar is only festering ready to come back at banks, investors and servicers emitting even more energy than before. Point being, I have seen very **little forward looking analysis on the imminent loan loss risk from the most risky loans on a bank's balance sheet...modifications**. Prime, Jumbo Prime, Alt-A and Subprime are all neatly categorized and given weighting but millions of mods and restructurings performed over the past 12-18 months are largely rebucketed with performing or non-performing assets and glossed over. Or, thrown in a TDR bucket with no metrics given to the make-up of the portfolio's.

In fact, because the lion's share of all mods were initiated in 2009 -- with the three to five month teaser payment trial periods involved that make for a larger percentage of successful trials than old-vintage mods with no trial periods -- many borrowers are making it to the six month threshold that allows the bank to ring the register and pull back reserves due to the year change.

2) -A Truly Toxic Combination
-Mod Redefault Risk Could be Greater than Put-Back Risk in Near-to-Mid Term

This note is to provide evidence, which leads me to believe **I have been far too bullish** when analyzing and making projections about the impending modification redefault wave, of which the leading edge is upon us now. I now believe this wave with be larger than earlier anticipated and will mark an inflection point at which recent quarter's improvement in early stage delinquencies and defaults will suddenly begin to worsen leading to profoundly negative effects on house prices over the near-to-mid-term.

Bottom line - When reading through the recent GAO report through June '10 on HAMP **I learned that the typical trial mod coverts to permanent status " with an average loan-to-value ratio more than 150%".** I have been using a conservative LTV factor of 135% in my redefault models because present LTV information is not readily available or offered up by most servicers. **And HAMP is conservative relative to bank's private label/portfolio modification programs or Alt-A HAMP,** both of which cater to less-than-Prime borrowers and scenarios.

I have harped ad-nauseum on the HAMP permanent modification nose-bleed 65% DTI ratios as being higher than anything the worst bubble-year's exotic lender would have knowingly done from 2003-2007. But when factoring in a **150% LTV and 65% DTI**, it changes everything...**my 24-month, 30-day late redefault estimate shoots to over 80%.**

Treasury is aware of how badly HAMP mods will ultimately perform, which is why they are rolling out **HAMP 2.0 in the Fall** with a three-year principal balance reduction to 115% LTV. This will attract borderline and strategic defaulters helping to bolster the program's results. HAMP 2.0 is desperate attempt at salvaging credibility for two primary reasons... **1)** the only way they can better their results is entice borrowers who would have otherwise made their payment just fine **2)** at the end of the day **most borrowers with a 115% LTV and 65% DTI will have redefault levels similar to those with 150% LTV and 65% DTI**. This is because both borrowers are in the exact same position. Unless the 65% debt piece of the equation is brought down to 40% DTI -- regardless of the LTV -- mods will never work.

3) Effects on Credit & Housing

For months I have been pounding the table over the **distortion in new-era resi "credit" due to aggressive modification extend & pretend tactics** that really built momentum on the back of HAMP, around q309. I view the vast majority of this giant pool of distressed loans (that should have been imminent defaults and foreclosures), which were were magically turned into short-term, high-leverage re-performing loans, as an **entirely new channel of shadow defaults/ foreclosures**, which few are factoring into their loan loss or housing market projections.

Based upon when the trial modification surge really began to ramp -- and factoring in historical redefault timelines across similar loan types -- **the leading edge of the modification re-default wave is upon us now.** This secondary channel of distressed loans and real estate will force foreclosures and HAFA (short sale & deed-in-lieu) liquidations much higher. As total real estate sales volume remains depressed post tax-credit but foreclosure resale and short sale volume increases,**the distress-to-total sales mix will snap back violently** from the past few month's low 30% level to perhaps as high as 50%...a level not seen since late-2008 to early-2009 when reported median and average house prices were still in free-fall.

Over the past few months it has become obvious that the trial modification, can-kicking experiment has run out of eligible victims based upon new mod applications running at 25% of peak levels only six to nine months ago. Ultimately, I believe**the lack of new borrowers entering the modification pipeline and wave of modification redefaults upon us now will result in a near-term "credit" event** where the last two quarter's of improvement in early stage delinquencies and defaults suddenly begin to worsen.

4) -GAO Report on HAMP
-Average LTV >150%

For those of you that still don't have your heads around how badly structured HAMP mods really are, attached is the fascinating GAO report on HAMP through June. By providing even more leverage than the original loans the borrowers are defaulting from, HAMP is analogous to giving a cancer patient anti-psychotics and pain drugs versus trying to cure the disease through surgery and chemo.

On page 15, they describe perfectly why most HAMP mods (high-leverage loans disguised as homeowner assistance loan restructurings) will fail and why at the end of the day **the entire HAMP exercise will be boiled down to a method of keeping defaults from banks and foreclosures from the market, rather than a program designed to truly help borrowers keep their homes.**

Page 15 - Why Most HAMP Mods Will Fail

Even during the worst times of the bubble years, no lender eve
originated a loan with an LTV "over 150%" and a DTI of 64%.

In fact, the vast majority of all stated-income liar loans never h
leverage associated with them.

Borrowers who received permanent first-lien HAMP mo
high levels of total debt and high loan-to-value ratios. Th
May 2010, borrowers receiving permanent HAMP modifi
median back-end debt ratio (the ratio of total monthly d
monthly income) of roughly 80 percent prior to loan mo
median reduction in monthly mortgage payments as a re
roughly $514, which reduced these borrowers' median b
income ratio to 64 percent. In addition, according to Fa
mid-April 2010, many borrowers continued to be underw
modification, with an average loan-to-value ratio more t

Best Regards,

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