

NOVEMBER 1, 2008

FDIC Plan Tests Limits of Leniency

By [MICHAEL M. PHILLIPS](#) and [RUTH SIMON](#)



Some 500 people jammed into a hall at the Most Holy Rosary Church in Antioch, Calif., for Monday's rally, organized by the Contra Costa Interfaith Supporting Community Organization and another faith-based group, the PICO National Network.

"It's not that the FDIC has helped everybody or that it's a perfect process, but it's really dramatically different," says CCISCO director Adam Kruggel.

ANTIOCH, Calif. -- When the Federal Deposit Insurance Corp. seized control of IndyMac Bancorp -- the nation's 10th-largest mortgage lender by loan volume -- the agency vowed to ease terms for many of its troubled borrowers. In doing so, the FDIC wanted to show the mortgage industry how it could slash home foreclosures by making decisions both sensible and humane.

The new entity, called IndyMac Federal Bank, has become a laboratory test of whether the FDIC's program can keep people in their homes. While it has already seen some success, the agency has also run into obstacles familiar to private lenders and loan servicers. The upshot: there are no easy solutions to the foreclosure crisis.

The FDIC launched its aid program in August, five weeks after the government took over IndyMac, which failed under the weight of its bad real-estate lending. The agency found plenty of bad loans to work with. IndyMac's specialty was Alt-A mortgages, a category that frequently includes loans made with little or no documentation and exaggerated borrower incomes.

"Our goal is to get the greatest recovery possible on loans in default or in danger of default, while helping troubled borrowers remain in their homes," said FDIC Chairman Sheila Bair at the time.

Ms. Bair has emerged at the forefront of the public debate over how to keep people from losing their homes and has jawboned the Bush administration to make more aggressive efforts.

In total, IndyMac services about 653,000 mortgage loans on behalf of itself and other investors. About 65,100 are "seriously delinquent," generally meaning at least 60 days late. Of those, the FDIC says roughly 47,000 might meet its criteria for a new loan.

The FDIC has already completed loan modifications for 3,500 borrowers. Several thousand more have accepted the FDIC's offer, though their modifications are still being processed. On average, those who have renegotiated have seen monthly house payments cut by more than \$380, or about 23%, the FDIC says.

But the agency has had difficulty getting responses from some borrowers. It's walled off from renegotiating some loans that were sold to other investors. And it still has to engage in thorny decisions of who deserves help and who doesn't.

"It's not that the FDIC has helped everybody or that it's a perfect process, but it's really dramatically different," says Adam Kruggel, director of the Contra Costa Interfaith Supporting Community Organization, a faith-based group advocating for homeowner protections. He believes no other lender has approached the problem in such a systematic fashion.

Ms. Bair is now pushing a separate plan, close to being finalized by the White House, in which the federal government would help keep borrowers in their homes by absorbing a portion of any losses on a modified loan. That could help as many as three million homeowners.

The FDIC says its goal is to reduce the cost of IndyMac's failure by increasing the value of its portfolio. "This is not a social program," says FDIC special adviser for policy Michael Krimminger. "This is about maximizing the value of the mortgages. That will also help keep more people in their homes."

The FDIC has said it expects losses on IndyMac to total \$8.9 billion. But the cost to the insurer could be lower if the loan-modification program is successful, FDIC officials say. In that case, bids for IndyMac assets may come in higher.

The mixed results of the IndyMac experiment are visible throughout Contra Costa County, a heavily Hispanic area where reckless lending -- and reckless borrowing -- fueled tracts of development.

In Antioch, a city of some 100,000 residents, 1,137 homeowners were in default this month. More than 2,100 homes are already back in bank hands, the most in the county.

Jaime Aguilar, a 37-year-old truck driver in Antioch, stopped making his house payments in August. In early October IndyMac offered to switch him from an interest-only loan into one that would permit him to pay off some principal -- and cut his monthly payments by \$336 for the next five years. He signed up immediately. He's still delinquent on a second home loan from [Wells Fargo](#) & Co.

Luis Flores, a 30-year-old bartender from Oakley, has watched the balance on his adjustable mortgage balloon from \$424,000 to \$463,000 in three years, while the value of his house dropped from \$530,000 to less than half that. Twice he has sent proposals to IndyMac detailing how much he can afford to pay. But the bank, he says, hasn't given him serious consideration. (A bank spokesman said he couldn't comment on Mr. Flores's specific situation, but said that IndyMac is able to do more for borrowers now than it was even a few weeks ago.)

Meanwhile, the Flores family, which fears eviction, is now looking for a place to rent. In his mortgage file, Mr. Flores keeps a note that reads:

1. Take deep breath daily.
2. Talk with wife about stress.

Most mortgage companies revise loan terms -- a process called modification -- one by one, a costly and time-consuming process. The FDIC's innovation was to create a comprehensive program with clear guidelines. It reworks delinquent loans so that a borrower's monthly payments for principal, interest, taxes and insurance equal no more than 38% of his or her income. To do this, the FDIC will first reduce the borrower's interest rate. In addition, it may extend the loan term and, where it can, base monthly payments on a smaller loan balance.

The FDIC reviews information from tax returns to document borrowers' incomes before any deal is finalized.

In late August, the FDIC mailed 7,500 letters to delinquent borrowers for whom IndyMac had recent financial information. The missive was an offer to reduce monthly payments. Roughly three-quarters of recipients responded. In the past three weeks, the FDIC mailed offers to another 7,500 borrowers for whom it also has financial information.

In addition, the FDIC has sent letters to another 19,000 borrowers for whom it had no recent financial information. It asked them to get in touch with IndyMac and provide financial information to determine if they qualify for a fast-track modification. So far, just 10% have responded, less than what the FDIC would like to see.

One lesson the FDIC learned, Mr. Krimminger says, is that "if you tell them what their new monthly payment is going to be, they are much more likely to respond."

Many borrowers complain they have a hard time getting IndyMac to respond to their pleas for help. When they do make contact, they're often told they can't get assistance unless they're already delinquent on their payments. (The FDIC says that it is working to address any concerns about IndyMac's responsiveness to borrowers.)

"If it was easy, everyone [in the mortgage business] would have done it already," says Mr. Krimminger. He says the FDIC's project demonstrates it is possible to modify thousands of mortgages simultaneously -- something the industry has struggled to do.

There are limits to what the FDIC can and will do. The agency says it will modify loans through the streamlined program only for borrowers living in the property. (The idea is to avoid rewarding real-estate speculators.) It also won't rework a loan if it can get a better return from foreclosing on the property and then selling it. About one in four delinquent loans fails this test.

Furthermore, the FDIC has less flexibility in cases where IndyMac doesn't own the loans but acts as a collection agent for investors who own mortgages or mortgage-backed securities.

Nanci Puerto, a 40-year-old house cleaner in Antioch, ran into such a problem. She refinanced her house for \$637,288 from IndyMac in 2006, taking out cash for a down payment on another property. She and her husband, who works in a machine shop, take home a combined \$70,000 a year. Each month, she makes the minimum payment on her loan, \$2,416. At the same time, she watches the outstanding principal swell since that payment doesn't fully cover the interest costs. Now she owes IndyMac \$707,000, on a house that the county tax assessor says is only worth \$410,000.

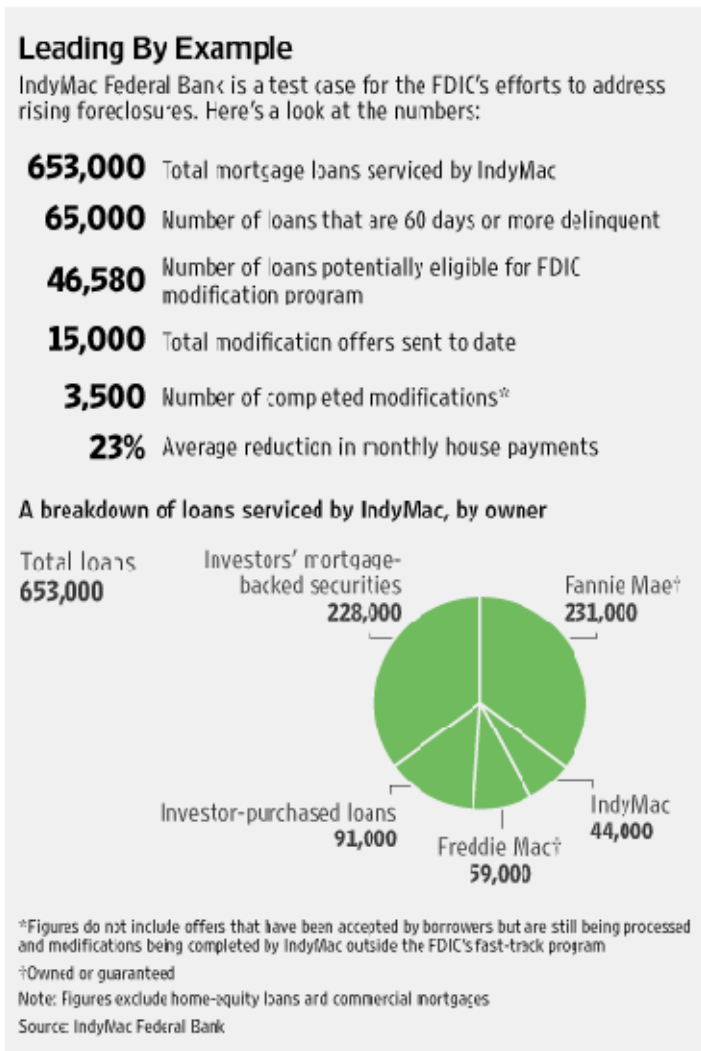
When she called the bank, however, she says the agent told her IndyMac is just a "collector" for the investors who own her mortgage. The bank could only consider altering her mortgage terms if she were delinquent.

"I'm going to stop paying so they'll modify the loan," Ms. Puerto said this week. "Otherwise they won't help me."

The FDIC can work with borrowers who are likely to become delinquent if IndyMac owns the loans. In cases where it does not own the loan, the bank's contracts allow it to intervene only if borrowers are actually delinquent. It can't do anything to help borrowers who haven't yet missed a payment, even if a default is in the cards.

Mr. Krimminger described that limitation as "one of the frustrations" that FDIC is experiencing at the helm of IndyMac.

Bertha and Nicolas Bobadilla, of Brentwood, a town not far from



Antioch, are making their payments but don't think they can hold on for much longer. There's not much the FDIC can do. Mrs. Bobadilla, 45, is an out-of-work house cleaner, while Mr. Bobadilla earns about \$36,000 a year as a tree trimmer. In recent years, the couple borrowed heavily to buy houses for various family members, a bet that depended on ever-rising house prices. One home has already gone back to the bank.

The Bobadillas are scraping together enough to make the roughly \$1,607 monthly payments on a three-bedroom house in Redding, their likely fallback residence.

Mrs. Bobadilla has unsuccessfully sought IndyMac's help on several occasions. Trying again this week, she was twice disconnected. When she got through to a Spanish-speaking agent, he told her: "Your only option is to refinance, ma'am." And he warned her that if the house is worth less than the existing mortgage -- a certainty -- she'd only be able to refinance if she paid the difference up front, something she can't afford.

"But I heard on TV that you have a new program" to help borrowers, she said.

"That program is only for those who are behind on their payments," the agent told her.

Mr. Krimminger said the FDIC strongly discourages borrowers from skipping payments in the hopes they will qualify for aid. "We are taking every step we can to make sure that call center people are providing accurate information to consumers," he said, "but we can't control every conversation between call-center employees and borrowers."

Borrowers who are delinquent won't qualify for a loan modification if the FDIC determines they can afford their payments, he says. Those who fall behind are likely to ruin their credit.

Rafael Martinez is a 31-year-old stucco worker in Pittsburg, Calif. earning \$3,600 per month at his union job. He has two IndyMac loans that ballooned to \$420,000. He originally borrowed \$400,000. His wife lost her job and he hasn't made a payment on either loan since March. He figured the house was lost. In hopes of saving his credit rating, he arranged a \$150,000 short sale in which the bank would agree to cancel his mortgage in exchange for the proceeds.

Before the sale closed, a housing counselor contacted IndyMac on his behalf. On Sept. 25, the day after what was to have been his foreclosure date, IndyMac sent him a letter that read: "If you are eligible, we may be able to permanently modify your mortgage, bring past due amounts current, and provide you with an affordable monthly payment."

He's optimistic the FDIC will accept his application. It is, he figures, in the bank's best interest, too. His neighborhood is pocked with empty homes, their yards gone as brown as the wild hills visible over the rooftops. One family around the corner simply disappeared one day. Not long ago he saw someone break into a house vacated.

Posted in the living-room window of a vacant down the street is a sign saying: "This home is protected by Wachovia." Wachovia, a big North Carolina bank, almost failed recently and has agreed to be bought by Wells Fargo.

Every other day or so, Mr. Martinez's wife asks him: "When are we leaving the house?"

"I don't think we are leaving the house," Mr. Martinez responds.

In a safe at a relative's house, he has socked away money he saved by not paying IndyMac. He says he's ready to turn it over to the bank when they come to an agreement on an affordable mortgage.

Write to Michael M. Phillips at michael.phillips@wsj.com and Ruth Simon at ruth.simon@wsj.com

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved