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Mr. Chairman, Members of the Committee, thank you very much for inviting me to testify today. My name is Bruce Gottschall and I am the Executive Director of Neighborhood Housing Services of Chicago (NHS of Chicago). I appreciate the opportunity to share with you the experience NHS has had in helping families facing foreclosure in Chicago and how that experience can and should inform a federal response to the foreclosure crisis. In our experience, the federal government's efforts to address the foreclosure crisis through the Emergency Economic Stabilization Act (EESA) have been in good faith, but the effects are not trickling down to home owners fast enough and are not leading to significant reductions in foreclosures. Until the federal response focuses on homeowners, not just financial institutions, these efforts will be ineffective.

NHS has been working on addressing foreclosures in Chicago's neighborhoods since 2002 through the Home Ownership Preservation Initiative (HOPI). This partnership of lenders, servicers, regulators, non-profit counselors and the City of Chicago led by NHS of Chicago has proved to be an effective venue for identifying and addressing issues related to foreclosure. Our work here in Chicago has become the national model for communities and local governments seeking to mitigate the impact of foreclosures on their own neighborhoods.

NHS uses its own experiences working with foreclosure clients to inform the HOPI effort. Our organization assisted over 2,000 individuals seeking advice about avoiding foreclosure last year and this year we are on track to see more than 3,000. There is no typical foreclosure client, which is why there is no silver bullet to solving the foreclosure crisis. Rather, there is a wide range of individuals experiencing foreclosures cutting across income levels, demography and loan type.

NHS conducted a review of our clients' financial characteristics over the last year and developed a map or typology that helps us identify, sort, and assist clients more quickly. It also helps us understand the nuances and complexities of the foreclosure crisis. Based upon our review of other foreclosure data from around the country, we are confident that this typology is a representative cross-section of the subprime mortgage market. This typology is attached to my written testimony.

In essence, this information shows us 11 % of distressed homeowners are in a strong enough financial position that they can avoid foreclosure by simply working out a traditional repayment plan with their lender. Another 29% could avoid foreclosure if their lender would modify the interest rate of their mortgage down to 6% or lower. Thus, for approximately 40% of homeowners facing foreclosure, a possible solution already exists that could keep them in their home if the loan servicer and investor are willing and able to offer that solution.

For the remaining 60%, their principal balances are too high for the loan to be sustainable regardless of interest rate. In order to avoid foreclosure, some form of principal deferral or reduction coupled with an interest rate modification is necessary. Depending on the homeowner's income, the amount of principal deferral/reduction necessary ranges from a few thousand dollars up to half of the outstanding principal. In fairness, there are severe cases in which no argument can be made to justify foreclosure avoidance methods and in some cases, as with speculative investors, little effort should be made. However, in many cases, principal reduction makes sense for both the homeowner and investor.

For those clients who can be saved from a foreclosure, housing counselors, such as those at NHS, are important players when it comes to securing a loan modification, workout plan, or principal write-down. Housing counselors serve as trusted third parties who can assist borrowers in assessing their situation, help them create a realistic budget, and collect the necessary documents for the servicer to make a decision. While individuals in foreclosure will frequently avoid their lenders because they feel intimidated or afraid, they will talk openly and honestly with a counselor who can then bridge the communication gap between the borrower and the servicer.

NHS has the largest staff of housing counselors working on foreclosure in the City of Chicago. Our experience working with servicers is a valuable example of what other counseling agencies and borrowers are also experiencing as they attempt to work with loan servicers. The shortfall of loss mitigation efforts we have seen highlights the need for increased action by regulators, either through the existing authority under EESA or other mechanisms to achieve the outcomes we all expect and desire.

Senior leadership of many lending and servicing organizations have expressed their commitment to helping owners avoid foreclosure. Unfortunately, this does not seem to be translating into increased workouts and loan modification offerings nearly fast enough to address the foreclosure crisis. While some of our HOPI lending and servicing partners have taken action to increase the capacity of their organizations to work with housing counselors and offer loan modifications to their clients, the results across the industry have been spotty at best.

In the best situations, servicers set up separate departments or staff contacts to work directly with housing counselors. In these cases, the counselors are able to expedite the modification process for the servicers by collecting completed documents from the client in person, eliminating much of the back and forth that otherwise occurs between the borrower and servicer. They can also assist the borrower in developing a realistic budget and push back when the servicer wants to owner to enter into an unsustainable modification. These efforts lead to a quicker more sustainable outcome and a foreclosure avoided.

In the worst situations, and these are still the majority, clients and counselors are bounced back and forth between the collections and loss mitigation departments. Their calls are frequently dropped in the process. When they call back, there are rarely any notes from the last conversation they had with the servicer so they have to start over again. Fore example, one of our counselors made 17 separate contacts with one servicer over four months in order to get that servicer to correct a mistake they had made which was forcing our client into foreclosure in error.

Most servicers continue to staff their loss mitigation departments with individuals who either lack the authority or the knowledge, training and expertise to make decisions about loan modifications or principal write-downs. Many servicing staff come from a debt-collection background and do not receive adequate training on loss mitigation and the role of housing counselors and so are unable to leverage the resources and expertise of local counseling staff to help families avoid foreclosure. Counselors' inability to access the decision makers means some of the most creative and cutting edge strategies to avoid foreclosure are not being used by servicers.

For example, over a year ago, NHS of Chicago developed a grant program through which our non-profit lending arm, Neighborhood Lending Services, offered to refinance homeowners out of unsustainable, mortgages and into 30-year, prime rate fixed mortgages. This was intended for customers for whom either the outstanding principal was too much for the homeowner to afford even at the prime rate or for whom there was considerable negative equity. We offered grant money to the servicers on condition that they would match the grant with a commensurate principal write down in order to achieve an affordable new loan balance for the homeowner. Fewer than 5 servicers approved writes downs of even a few thousand dollars. Despite the fact that investors stood to lose tens of thousands of dollars more if they proceeded with a foreclosure, they would not agree to any principal reduction.

Efficiency is also a challenge. Despite advances in technology, loss mitigation departments still rely on faxing documents back and forth between borrowers and the servicer. These documents are frequently lost or misplaced and the process must be restarted over and over again. These small delays quickly add up to days, weeks, and even months during which additional fees accrue and the homeowner becomes discouraged and gives up. When homeowners and housing counselors call servicers, too often they remain on hold for long periods of time and are transferred numerous times before they speak to someone. Files are shuffled between departments without any apparent rhyme or reason and there is a disconnect and lack of communication between and even within these departments. All of these inefficiencies mean that many homeowners who could avoid foreclosure are falling through the cracks. This should be considered unacceptable during such a crisis and regulators should step in to demand better results.

In response to this problem, NHS and a handful of servicers are now using a new online service called "Best Fit," which allows NHS and participating servicers to track clients and scan and upload documents into a universal database, and to which only the servicer and counselor have access. This online platform shows great promise for reducing the unnecessary delays and waste that are keeping people from avoiding foreclosure. However, more servicers need to adopt this tool and train their staff in its use to maximize benefit.

Another challenge is that when servicers do loan modifications, the modifications are often unaffordable, which means they frequently fail down the road. A review of 60 loan modifications that were facilitated by NHS of Chicago counselors showed that fully one third of loan modifications offered to borrowers in distress had housing ratios of over 50%. In these cases, the interest rate was typically frozen at its current level and the arrearage, costs, and fees were capitalized. Another 34% had housing ratios between 35 and 50%, which means they were on the verge of being unaffordable and had a significant likelihood of failure. It was only the final third of the loan modifications that had reasonable housing payment ratios giving the homeowners a real chance for long-term sustainability.

Our analysis is confirmed by recent reports that approximately 50% homeowners receiving loan modifications re-default within a few months. Since two-thirds of loan modifications are essentially unworkable from the outset, it is no wonder that half of them fail. However, I urge you not to draw the same conclusion that some housing market observers have reached: namely, that loan modifications do not work and lenders ought to foreclose instead. Instead, consider the fact that good loan modifications that create a reasonable housing payment do work over the long term and can go to great lengths to stem the tide of foreclosures.

While we believe that the efforts outlined in the Emergency Economic Stabilization Act were developed with the best of intentions, these experiences show that the impact of the efforts thus far are not leading to increased efforts to avoid foreclosures by lenders and servicers and are also not translating into access to capital for individuals to purchase homes, a necessary next step for market recovery. We feel this is because the efforts thus far have focused on the impact of foreclosure to the market, not on helping individual homeowners avoid foreclosure.

Some of our counselors even report that during October and November servicers became less willing to offer loan modifications – a response they attribute to financial institutions waiting to see if their troubled assets would be purchased.

It had been our hope that if the government purchased the troubled assets of struggling financial institutions that they could in turn offer standardized loan modifications and principal reductions in such a way that large numbers of foreclosure could be avoided in an efficient and effective way. In the absence of such a program it appears that lenders and servicers have not taken sufficient steps to reduce foreclosures on their own.

For these reasons, NHS supports efforts to compel mortgage holders to offer proactive, standardized loan modifications to large numbers of mortgagees in a systematic manner such as the method employed by the FDIC with the Indy Mac portfolio. We feel that all lenders and servicers should undertake similar efforts immediately in order to assist the maximum number of families avoid foreclosure. The FDIC has even provided template documents for other investors and servicers to use to replicate their mass loan modification program, which are available on their website.

Along this line, NHS also supports the more recent proposal by the FDIC to partially insure affordable and sustainable loan modifications made by servicers, which we feel would create appropriate incentives for mortgage servicers and investors to take the necessary steps to stem foreclosures. Further, regulators should require that all servicers report on not only the number of loan modifications they offer, but also the affordability of these loan modifications. As I have just outlined, loan modifications are a crucial component to addressing the foreclosure crisis, so additional information about the use and structure of loan modifications is essential.

Also, the issue of principal deferral or reduction is clearly the cutting edge of foreclosure prevention and I encourage you to do all you can to help move it from being only a theoretical option to one that's used judiciously in cases where it makes economic sense. As positive examples of what has already been done, the leadership shown by the FDIC in its handling of the IndyMac portfolio, along with the recent announcements by Fannie Mae and Freddie Mac, have made significant progress towards making principal deferral or reduction the industry standard in cases where it maximizes net present value. However, more must be done. Servicers need guidance on how and when to engage in principal deferral or reduction.

Finally, NHS would like to see regulators make clear to the recipients of the TARP funds their responsibility to use those funds to originate mortgages in LMI communities. NHS has seen an increase in clients needing to use our purchase loans because they cannot get traditional financing through banks. This remained the case during the last two months when lenders should have been expanding their willingness to lend the capital they received through the EESA.

We have received numerous calls from homeowners in trouble asking what the rescue plan means for them. Unfortunately, thus far, it is unclear that homeowners and neighborhoods are experiencing any real benefit from the $350 billion invested in our financial services industry.

As the committee looks for suggestions on how to adapt the program, it would be our advice that new efforts focus on homeowners in foreclosure and the neighborhoods in which they live.