GROWING MORTGAGE FORECLOSURE CRISIS: IDENTIFYING SOLUTIONS AND DISPELLING MYTHS

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

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GROWING MORTGAGE FORECLOSURE CRISIS: IDENTIFYING SOLUTIONS AND DISPELLING MYTHS

TUESDAY, JANUARY 29, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:04 p.m., in room 2141, Rayburn House Office Building, the Honorable Linda T. Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Conyers, Sánchez, Johnson, Lofgren, Watt, Smith, Chabot, Cannon, Keller, Franks, and Jordan.

Staff present: Susan Jensen, Majority Counsel; Zachary Somers, Minority Counsel; and Adam Russell, Majority Professional Staff Member.

Ms. SÁNCHEZ. This hearing of the Committee of the Judiciary, Subcommittee on Commercial and Administrative Law will now come to order.

I will recognize myself for a short statement.

We are undoubtedly in the midst of an economic crisis fueled by the subprime mortgage meltdown and falling home prices. Both the Administration and Congress are seeking solutions to stem this crisis.

Last year the House passed comprehensive reforms that would prospectively set higher standards for the mortgage lending industry. We have already provided relief for homeowners with respect to the tax consequences of cancellation of indebtedness through a bill signed into law last December. And both the House and Senate are currently considering economic stimulus packages.

Additionally, last month the Judiciary Committee reported H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007," legislation that I introduced with Congressman Brad Miller. We worked with Chairman Conyers and our colleague on the other side of the aisle, Steve Chabot, to amend the bill in a bipartisan fashion.

About the same time, Treasury Secretary Paulson announced a voluntary plan by which servicers and others in the mortgage industry could temporarily freeze the interest rates for certain homeowners who are current on certain mortgages and who have specified FICO scores.

And the financial services industry is promoting a program that is intended to proactively reach out to homeowners in financial distress.

What is clear is that the complexity of the mortgage crisis requires all of these responses, and perhaps even more aggressive solutions. Today's hearing will provide an opportunity for us to consider how some of these responses will address the crisis and to dispel the untruths about the Miller legislation with this Conyers-Chabot compromise.

Experts predict that the worst is still ahead, as a large majority of subprime borrowers will face a 40 percent or greater increase in their monthly mortgage payments, once their initial teaser rates expire and their fixed interest rates reset into higher variable rates early this year.

People are losing their homes, and neighborhoods have gone from vibrant to desolate. It is my hope that today's hearing on the subprime issue will aid us in our examination of the possible solutions to this mortgage mess and demonstrate the need to act quickly to resolve this issue.

Accordingly, I very much look forward to hearing from our witnesses today and appreciate their efforts in helping us respond to this crisis.

At this time I will now recognize my colleague, Mr. Cannon, the distinguished Ranking Member of the Subcommittee, for his opening remarks.

Mr. CANNON. Thank you, Madam Chair. This is in fact the third hearing that I think we have had on this issue, and so I would ask unanimous consent to make my statement available for the record. And in addition to that, I have a series of items for the record.

One is a *Wall Street Journal* article today called "A Mortgage 'Tweak' We Don't Need." The second is the testimony that would have been given by Mr. Dick Armey, if he had been here today. The third is a statement on behalf of the American Bankers Association dated today.

In addition to that, we have a letter that is from a series of associations, beginning with the American Bankers Association, the American Financial Services Association and several others. We have a letter on the HOPE NOW Alliance from Congressman Frank and Congressman Bachus. And then this is testimony from Frank Keating in 1991 in the Senate Judiciary hearing on cramdowns of home——

If we could have those admitted to the record, I would appreciate that.

Ms. SÁNCHEZ. Without objection, so ordered.

[The prepared statement of Mr. Cannon and the information follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND RANKING MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Subcommittee Hearing Statement for
Ranking Member Chris Cannon,
Hearing on the Growing Mortgage Foreclosure Crisis
January 29, 2008, 2:00 p.m., Room 2141 RHOB

Today's hearing is the third we've had on the subprime mortgage crisis. The title for this hearing is "The Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths." I think that is an appropriate title.

Throughout the previous hearings and markups on the mortgage bankruptcy bill we've heard numerous myths put forth that need to be dispelled. We've also identified numerous solutions, other than bankruptcy reform, to the subprime crisis.

Let me begin with a few of the myths offered in support of the mortgage bankruptcy bill:

- First, it's been stated repeatedly that this bill will treat home mortgages no differently than loans on vacation homes, investment properties, or car loans. This is simply not the case. I would commend to you Professor Mark Scarberry's testimony before the Senate Judiciary Committee explaining why this argument is false and I ask unanimous consent it be entered in the record.

- Those in favor of the bankruptcy bill have also put forth the myth that bankruptcy relief is costless. Again, this is incorrect. H.R. 3609 will have a significant cost on future borrowers and current homeowners seeking to refinance, as interest rates rise to make up for increased risk. It will also impose costs on those who are encouraged to file bankruptcy

because of this bill. The federal government will pay as well, as the bill will drag HUD-backed loans into bankruptcy.

- Another myth that has been offer in favor of bankruptcy reform is that bankruptcy courts will be able to handle the increase in Chapter 13 bankruptcies that will be created by the bill. As Professor Scarberry noted in his Senate testimony, "it is not clear that the bankruptcy courts could handle enough chapter 13 cases quickly enough to deal effectively with the current problems and those on the near horizon."

These and other myths all attempt to argue for the same conclusion: that the bankruptcy bill is a simple, effective, and costless solution to the subprime crisis. It is not.

However, outside of bankruptcy there are some real, identifiable solutions to the subprime crisis. Some of these solutions are already helping subprime borrowers; others are poised to be enacted. We need to allow the non-bankruptcy solutions time to work before we even consider bankruptcy relief.

The first of these solutions are loan modifications. Lenders and servicers are working with subprime borrowers on a case-by-case basis to modify subprime loans that have reset or are scheduled to reset. Streamlined modifications under Secretary Paulson's Hope Now framework are also underway. And the news is good.

Hope Now's recently released data shows that nine of the largest loan servicers were able to assist 370,000 subprime

borrowers during the second half of 2007 alone. That's 39 percent of their delinquent subprime borrowers. These numbers don't even include those that will be helped under the Paulson Plan.

The Federal Housing Administration has also been able to assist troubled subprime borrowers through its FHA Secure program. According to the FHA, in just the first four months of the program, it has helped 53,000 borrowers refinance subprime loans. Moreover, FHA is on target to assist 240,000 additional borrowers in fiscal year 2004.

And more help from the FHA and Government Sponsored Entities, such as Freddie Mac and Fannie Mae, is on the way. The recently announced economic stimulus package will include increase in FHA and GSE loan limits. This will allow more

subprime borrowers to refinance into the more affordable loan products offered by these entities.

These are real solutions.

I fully understand that the bankruptcy bill may, at first blush, appear to be an attractive answer. But the costs of the bill far outweigh its benefits. Moreover, the bankruptcy bill will undermine the other solutions that have been put in place to address the subprime crisis.

The answer to the subprime crisis is not to encourage hundreds of thousands of Americans to file for bankruptcy.

Before I yield back the balance of my time I'd ask unanimous consent to offer several documents for the record.

The first is the written testimony of former Majority Leader Richard Armey in opposition to the mortgage bankruptcy bill. Scheduling issues prevented Mr. Armey from being here with us today.

I also have written testimony from the American Bankers Association, a joint letter from mortgage industry groups, and a Dear Colleague letter from the Financial Services Committee regarding Hope Now.

Finally, I'd like to offer into the record the 1991 testimony of HUD's general counsel before the Senate Judiciary Committee while Mr. Kemp was the Secretary of HUD. The testimony outlines the problems cram down of principal poses for federal housing programs.

HUD's general counsel stated in part:

> Ginnie Mae is concerned, as is HUD, that the potential widespread practice of this form of debt relief could be extremely detrimental to the overall effectiveness of its chartered responsibility of increasing the supply of mortgage credit for potential home buyers. . . . Ginnie Mae and HUD are especially concerned that if cramdowns become more widespread, the lending community might be reluctant to lend to individuals, or possibly in certain communities arbitrarily determined to be areas of potential cramdown risk. . . . The impact to the Ginnie Mae issuer community and, therefore, Ginnie Mae could be devastating if the cramdown alternative is readily available as a form of mortgage abatement.

I yield back the balance of my time.

ARTICLE FROM *THE WALL STREET JOURNAL,* TITLED "A MORTGAGE 'TWEAK' WE DON'T NEED," DATED JANUARY, 9, 2008

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January 29, 2008

COMMENTARY

A Mortgage 'Tweak' We Don't Need

By DICK ARMEY
January 29, 2008; Page A17

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Politicians are always willing -- if not quite qualified -- to play the role of economic savior. And with fresh bad news about the economy coming out regularly, there are plenty of would-be saviors auditioning for the role.

Some of their proposals are serious reforms. Others are Keynesian-inspired, more silly than harmful. But too many are dangerous ideas that would undermine recovery and do long-term harm to both homeowners and our general prosperity.

One of the most dangerous proposals is now moving through the House of Representatives. The Emergency Home Ownership and Mortgage Equity Protection Act was voted out of the Judiciary Committee recently. It takes aim at Chapter 13 bankruptcy proceedings to make it easier for buyers to rewrite the terms of their mortgage contracts in court. It would do this by changing how a debtor's principal residence is treated in bankruptcy, allowing mortgage contracts to be modified by the courts.

In short, if this bill becomes law a mortgage would no longer be a matter between a borrower and a lender, but instead, between a borrower, a lender and a judge. Rather than interpreting private contracts, judges would suddenly be able to rewrite them.

Current bankruptcy law has existed for more than 100 years, and was designed to promote homeownership by making mortgages secure from outside meddling. Strong contracts make for a vibrant mortgage industry. Weakening mortgage contracts would endanger the future of American homeownership by making it harder for homebuyers to obtain a loan.

The bill's backers, of course, claim otherwise. Former Housing and Urban Development Secretary Jack Kemp, for instance, argues that this is merely a "tweak" to the law that would benefit subprime mortgage holders at risk of foreclosure. According to Mr. Kemp, "when servicers are unwilling or unable to

voluntarily modify exploding, unsustainable home mortgage loans, Congress has a duty to consider involuntary modification in bankruptcy court." This type of modification is more commonly known in the industry as a "cram down."

By introducing uncertainty into mortgage contracts, this rule change would make it harder and more expensive for buyers to get a mortgage. The Mortgage Bankers Association recently estimated that, if this reform becomes law, borrowers will have to start putting down 20% on a home to get a loan, which is much higher than today's standard. So in their efforts to cushion the fall of a few, advocates of this reform would raise costs on an untold number of future mortgage seekers.

Cram downs might not even provide security to those in risk of default. Changing the terms of a loan provides no assurance that the homeowner will not default at a later date. Moreover, recent research by the Federal Reserve Bank of Boston suggests that subprime borrowers are particularly susceptible to fluctuations in home prices. The end result of assistance may be to prolong the problems in the subprime market by extending the opportunity for borrowers to borrow to the point of default.

Only in Washington, where a billion dollars is treated as pocket change, could a change affecting millions of current and future homeowners, as well as the stability and success of the entire mortgage market, be referred to as "a tweak."

In recent congressional testimony on the economic stimulus package, Congressional Budget Office Director Peter Orszag noted that mortgages are treated differently than other property in bankruptcy, specifically to provide benefits to consumers: "The rationale for the current differential treatment of residential mortgages is that exempting mortgage debt from reduction [in bankruptcy] would lower mortgage interest rates and encourage homeownership." Mr. Orszag predicts that such a change in the bankruptcy laws will yield higher mortgage rates.

Not only does this upend more than 100 years of public policy promoting homeownership, it also raises important questions about the sanctity of contract. "The definition of injustice is no other than the not performance of covenant," wrote Thomas Hobbes in "Leviathan." Yet now, it seems that some in Congress want to enshrine breach of contract into the law itself, ostensibly in service of assisting the nation's homeowners. Such a move would not serve homeowners in the least, but it would surely be an injustice.

Mr. Armey, Republican majority leader of the U.S. House of Representatives from 1995 to 2001, is chairman of FreedomWorks.

See all of today's editorials and op-eds, plus video commentary, on The Editorial Page[1].

PREPARED STATEMENT OF THE HONORABLE RICHARD K. ARMEY, CHAIRMAN, FREEDOMWORKS

TESTIMONY OF RICHARD K. ARMEY

CHAIRMAN

FREEDOMWORKS

before the

COMMITTEE ON THE JUDICIARY,

UNITED STATES HOUSE OF REPRESENTATIVES

January 29, 2008

Good afternoon. Mr. Chairman and Members of the Committee: as you may know, after leaving my post as Majority Leader of the U.S. House of Representatives, I became Chairman of FreedomWorks, an 850,000 member grassroots organization that promotes market-based solutions to public policy problems. Thank you for inviting me to participate in today's hearing on "The Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths." On behalf of the members and supporters of FreedomWorks, I urge the Committee to approach with caution any proposals to allow bankruptcy judges to alter the terms of mortgage contracts after the fact. Such policies raise important concerns about the sanctity of contract, while making the promise of homeownership more difficult to achieve for many Americans.

A correction is currently underway in the housing market, and both buyers and lenders are already adjusting their behavior to deal address market concerns. Additionally, efforts such as HOPE NOW have been put in place to ease market pressures and help distressed homeowners. Finally, the proposed stimulus package raises the limits for loans offered by the Federal Housing Administration and the government sponsored enterprises. Prior to making fundamental changes to federal bankruptcy laws, it may prove useful to allow these changes to take effect in the marketplace. Additional bankruptcy relief for overextended lenders and distressed homebuyers will do little to address the current underlying market problems, but it will have long term impacts on the ability of Americans to acquire homes, and perhaps access to credit more generally.

Briefly, the "Emergency Home Ownership and Mortgage Equity Protection Act" (H.R. 3609), which was passed by the House Committee on the Judiciary in December of 2007, makes changes to Chapter 13 bankruptcy proceedings that will have a significant impact on homebuyers or those intending to refinance existing mortgages. Most fundamentally, the law alters the treatment of a debtor's principal residence in the bankruptcy proceeding, allowing the terms of mortgages to be modified by the courts. This change goes against both a long legislative history and legal precedent barring modification of mortgages on a principal residence. Historically, this unique treatment was viewed as furthering the important public policy of encouraging homeownership by reducing the uncertainty surrounding mortgage contracts.

H.R. 3609 threatens this objective with policies that will increase the risk of mortgage lending and drive up the costs of a mortgage for all borrowers. For example, the court would be able to reduce the total amount of the loan to be repaid (known as a "cram down") or reset the interest rate on a given mortgage. In addition, the proposed legislation would allow the mortgage debt to be paid over a long-term time frame that exceeds the traditional five years of a Chapter 13 bankruptcy plan. The bill also removes requirements for credit counseling before filing a petition for bankruptcy.

This is no "small fix" or "tweak" as some proponents claim. These proposals amount to a sweeping change in bankruptcy law that departs from over 100 years of settled practice. Quite simply, allowing the courts to rewrite contracts after the fact injects a substantial degree of uncertainty into the mortgage market. Making it more difficult for lenders to determine whether they can recoup loans does little to help homebuyers. In fact, lenders will respond by tightening credit standards and increasing down payment requirements while interest rates rise to capture the new uncertainties associated with mortgage lending.

In his testimony to Congress this week on an economic stimulus package, Congressional Budget Office Director Peter Orszag noted that mortgages are treated differently than other property in bankruptcy specifically to provide benefits to consumers: "The rationale for the current differential treatment of residential mortgages is that exempting mortgage debt from reduction [in bankruptcy] would lower mortgage interest rates and encourage home ownership."[1] His testimony continues to say that such a change in the bankruptcy laws can yield higher mortgage rates. A bankruptcy "cram down" will result in a new risk premium that will be a burden to all borrowers.

Not only does this upend more than a century of public policy promoting home ownership, it also raises important questions about the sanctity of contract. It is true that a bankruptcy is a unique circumstance that restructures many contractual terms; however, expanding access to bankruptcy petitions weakens the value of the original contract and should be avoided where possible. Providing *ex post* opportunities to alter a contract reduces the *ex ante* value of that contract, which creates incentives to secure the contract in other ways. In the case of mortgages, this can be done through a larger down payment requirement, higher interest rates, or a combination of the two. Additionally, lending standards will be tightened, making it more difficult to qualify for a loan in the first place.

Granting the courts the opportunity to modify the contract on a principal residence would not only increase mortgage rates, it can also put upward pressure on the rates of other sources of consumer credit. For example, if a judge approves a strip down that lowers a mortgage to $100,000 from $150,000, the debtor will be required to make payments on the $100,000 mortgage. The remaining $50,000 becomes an unsecured loan that is included with all the debtor's other unsecured loans. These are typically repaid for pennies on the dollar. However, with the additional mortgage debt now included in the

[1]Statement of Peter R. Orszag, Director Congressional Budget Office, "Options for Responding to Short-Term EconomicWeakness" before the Committee on Finance United States Senate, January 22, 2008, p. 24.

unsecured loans, a new creditor has been added, which can reduce the ability of all creditors to recoup their losses. Should this occur, interest rates on other forms of credit may increase as well.

The bursting housing bubble and subsequent subprime crisis have been identified as major contributing factors to the current economic situation. As such, many policy proposals have focused on the subprime market and the need to address the potential for increasing foreclosures. Even the recently announced economic stimulus package includes policies targeting the housing sector. However, altering the bankruptcy code to allow modifications to mortgages on principal residences will have no stimulative effect on the economy. CBO Director Peter Orszag noted that any such changes would generate caseload congestion in bankruptcy courts that would delay any impacts.[2] The procedural delays diminish any immediate economic impacts, while limiting the benefits provided to distressed homeowners.

One final note on the proposed modifications to the bankruptcy code proposed in H.R. 3609. The personal effects of bankruptcy are significant. For any individual, it is a costly and stressful process from which it takes years to recover. As such, in my view, it is poor public policy to promote an increase in bankruptcies. In some ways passing a law that simply turns distressed homebuyers over to the legal system to allow them into bankruptcy prematurely undermines existing public policies and reform efforts. I believe there are more prudent paths to reform that will strengthen the economy and address the concerns of overextended homeowners without resorting to a modification of bankruptcy laws.

The subprime market is a relatively new phenomenon that has provided avenues to homeownership to thousands of Americans who may otherwise not have had the opportunity to buy a home. Clearly, excesses and poor business practices have taken a toll on the market. But both buyers and sellers have responded, with tighter lending standards and less speculation, and the market is undergoing a painful, but necessary, correction process. In addition, efforts such as HOPE NOW—an alliance of lenders, counselors, and others—have emerged to help distressed homeowners. In the second half of 2007, more than 370,000 homeowners avoided foreclosure through the services of HOPE NOW. Elements of the stimulus plan will also have an impact on housing markets and the subprime problem; the impact of these measures should be evaluated prior to making any fundamental changes to the bankruptcy code.

Conclusion

Much of the current economic woe was caused by policies at the Federal Reserve that fueled the subprime bubble in the housing market. And while the president rightly points to concerns in this sector of the economy, the administration and Congress should be wary of imposing new regulations or exposing taxpayers to new liabilities in the housing market. A rush for federal intervention sends the wrong signal that risky behavior will be subsidized while making it more difficult for consumers trying to

[2] *Ibid.*, p. 25.

purchase a home. The market is in a correction, sorting out the missteps of the recent run-up in the housing market. It is a costly and sometimes painful process, but increased federal involvement may not necessarily improve the outcome.

Mortgages on primary residences have long been provided special treatment in the bankruptcy code, with the intended public policy goal of increased homeownership. Both Congress and the courts have recognized this in the past, and have specifically avoided modifications to mortgages on principal residences, primarily due to the adverse effects this would have on the costs associated with a mortgage. Congress should be wary of the impacts such a change would have on the housing sector and evaluate all the consequences—intended and unintended—before imposing any modifications to bankruptcy plans.

PREPARED STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

January 29, 2008

Statement for the Record
on behalf of the
American Bankers Association
before the
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
United States House of Representatives

January 29, 2008

The American Bankers Association appreciates the opportunity to submit a statement for the record on possible legislative changes to the Bankruptcy Code, particularly as embodied in the Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609. The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

There is no question that our country is going through a very difficult time as many homeowners struggle to meet their monthly mortgage payments. Changes to the Bankruptcy Code, while well-intentioned, are not an effective means to deal with the current situation, nor are they likely to prevent problems from repeating themselves in the future. In fact, the proposed changes embodied in H.R. 3609 are likely to have severe long-term consequences, raising the costs of a mortgage loan for ***every borrower.*** Making such changes now would hurt the very market that Congress seeks to help. It makes no sense to further restrict credit at a time when every effort possible is being made to stimulate the economy and avoid a recession.

The fallout of the mortgage markets has been very troubling to the banking industry – an industry filled with institutions that have existed for decades and are committed to serving our

communities for many more decades to come. The vast majority of banks were making basic mortgage loans that were underwritten on the basis of borrowers' ability to repay and with adequate documentation. We agree with Congressman Barney Frank, Chairman of the House Financial Service Committee, when he said: "Reasonable regulation of mortgages by the bank and credit union regulators allowed the market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis."[1] It has been the actions of loosely-regulated non-bank lenders, with little stake in the subsequent performance of the loans that they have made, that have caused much of the damage for consumers and for the industry. In fact, many banks tried to warn local consumers against "toxic" types of loans, only to watch as those consumers went down the road and took on obligations they did not understand and apparently could not resist – largely from non-bank mortgage originators.

Fortunately, banks are coming forward as part of the solution to the current challenges. Banks are well capitalized and are in a position to step in to refinance loans to help borrowers avoid foreclosure. We believe that the government and private-sector efforts to work with borrowers to avoid foreclosure are starting to take hold. Statistics compiled by MBA show that nearly a quarter of a million loans were put into repayment plans or modified in the third quarter of 2007. On January 18, the HOPE NOW alliance of counselors, lenders, and servicers reported that 370,000 homeowners were helped in the second half of 2007 through repayment plans and workouts, and that the number of borrowers being helped "is accelerating rapidly." At the same time, bankers are increasing their originations of new mortgages for buyers who want to purchase houses today. Both efforts are crucial to help keep our economy growing.

If H.R. 3609 becomes law, it will lead to too much uncertainty and raise costs for ***all*** mortgage loans. Banks will not know the value of their collateral and, in order to manage their risks prudently,

[1] *Boston Globe*, September 14, 2007.

will be forced to pull back from making some mortgage loans. Simply put, this is no time to change the rules on the way collateral is handled. Banks are in a position to help, but cannot do so effectively if uncertainty is injected into the rules. To change this policy now, especially when the country is facing a highly volatile and uncertain housing market, is bad public policy and would have several negative consequences for current and future homeowners, the housing market, and the economy. Therefore, the ABA strongly opposes the changes in the Bankruptcy Code that are being contemplated in H.R. 3609.

In our statement, we emphasize three key points:

- **H.R. 3609 will make it harder and more costly for consumers to obtain mortgages, which is exactly the opposite of what the mortgage market needs now.**

- **H.R. 3609 will encourage more bankruptcies and discourage borrowers from addressing problems early and working with lenders to facilitate a resolution.**

- **H.R. 3609 will eliminate required credit counseling which has helped reduce bankruptcy filings, facilitated workouts, and improved borrowers financial practices that benefit them now and in the future.**

I. H.R. 3609 Will Make it Harder and More Costly for Consumers to Obtain Mortgages

At the heart of the bill are provisions that would allow bankruptcy judges to alter the terms of mortgage agreements. If enacted, H.R. 3609 would allow judges to unilaterally cramdown a portion of the outstanding mortgage balance on a primary residence, thereby converting it from secured to unsecured debt. The bill would also allow judges to modify other mortgage terms such as the applicable interest rate and repayment period. Historically, these actions were prohibited because they would undermine the long-standing public policy to encourage liquidity in the mortgage market and increase home ownership. Specifically, when Congress rewrote the bankruptcy laws in 1978, it deliberately retained the prohibition on cram downs and other changes to first mortgages by bankruptcy judges to keep housing affordable for as many Americans as possible.

The provisions in H.R. 3609 will create new lending risks that will certainly raise the costs to lenders for making any mortgage loan and inevitably lead to higher mortgage interest rates and fewer loans made to all borrowers. The Mortgage Bankers Association (MBA) estimates that H.R. 3609 could increase interest rates on first mortgages by at least 1.5 percent. The impact is likely to be felt most strongly by higher-risk, but creditworthy, borrowers and may mean the difference between owning a home and continuing to pay rent to a landlord.

The interest rate that bank's set for a mortgage loan depends on several factors, including:

- The creditworthiness of the borrower (the ability and likelihood that the borrower will repay the debt);
- The collateral backing the loan (which the borrower pledges in the event of default);

- The costs of administering the loan (e.g., monitoring, servicing, legal actions, foreclosure, and the ability to take control and sell the collateral to recoup some of the losses on the loan); and
- The cost of funding the loan (e.g., deposit and secondary market funding).

Except for creditworthiness, all of these factors will be adversely affected by the proposal and will lead to higher interest rates and reduced credit availability. While we appreciate that the bill applies only to the primary residence, lenders already typically charge a higher interest rate and require a larger downpayment for second homes – which can be crammed down in a bankruptcy under current law. This is another indication of the potential consequences on first homes should the bill be enacted.

Value of Collateral is Diminished: The difference between interest rates on unsecured versus secured loans is substantial. The reason is simple: the expected loss once a default occurs is much greater for an unsecured loan than for a secured loan where the sale of the collateral can offset a portion of the loss to the lender. One need only look at the difference in interest rates on credit cards (which are unsecured) versus auto or mortgage loans. Thus, borrowers benefit significantly from pledging the collateral, and they also have more incentive to make the payments as they do not want to risk losing that collateral.

The changes proposed in H.R. 3609 make the underlying collateral less valuable and raise the expected loss on ***all*** mortgages for ***every*** lender. The unpredictability regarding how loan terms might change – whether it be a cramdown in value, or a change in the interest rate or other term of the loan – makes valuing the benefit of the collateral practically impossible. Slight changes in any of these terms can significantly affect the potential to recoup losses in the event the borrower declares bankruptcy. Lenders simply cannot predict at the time the loan is originated what changes in terms a judge may later impose. Therefore, because the value of the collateral is less certain, the interest rate reduction

borrowers enjoy from pledging the asset will be less and the interest rate paid on the mortgage will be higher.

Ability to Control the Collateral Will be Impaired: The ability to control the collateral pledged by the borrower and sell it to recover some of the losses is a critical component of secured lending. Without it, the collateral has little value and the loan will get priced more like an unsecured loan. The bill would make it more difficult for the lender (or the claim holder if the loan is sold in the secondary market) to exercise its contractual rights to modify the terms of the loan or to seize the collateral, further raising the potential for loss and extending the time for any recovery. Once again, the lender will raise interest rates to cover this uncertainty, require a larger down payment, and restrict lending to more creditworthy borrowers where the likelihood of default is much less. This means that deserving individuals who would not qualify for low-risk mortgages will find mortgage credit harder to come by and at a much higher cost – taking either a bigger bite out of their income or making the loan beyond their reach entirely.

Investors in the Secondary Mortgage Markets Will Demand Higher Returns: Another important cost that helps to determine the interest rate on any mortgage loan is the cost of funding. The low mortgage interest rates and broad availability of credit that characterize the U.S. mortgage markets are attributable to an active secondary market for mortgage-backed securities. Today, market conditions have made investors wary of mortgage-backed securities (particularly those that are not backed by prime loans). Investors have become concerned about changes in the payments being made on the underlying mortgages backing their investments. If H.R. 3609 were to be enacted, it would significantly add to the uncertainty about the performance of and expected income stream from mortgage loans. This will be particularly true of securities that are supported by pools of subprime loans where the likelihood of default, by definition, is much greater than for prime loans.

Adding yet more uncertainty for investors already made nervous by the market turmoil will delay the return of these markets. Investors do not like uncertainty. This is especially true of those with fiduciary responsibility to pension and insurance funds and others with low risk tolerances. These fiduciaries are increasingly concerned about the impact of the subprime housing problems and the uncertainty that surely will result from H.R. 3609 will make them far less likely willing to accept any mortgage-backed security in the future.

Because the proposed change gives judges wide discretion to choose which mortgage terms to adjust and to what degree, and because this discretion is likely to be applied in different ways across the country (and even differently within the same federal court), investors will not be able to rely on consistent treatment and will have difficulty assessing the true risk. As a result, they will either not buy the asset or will require a much higher return on their investment. This will make it far more difficult to reestablish the stability and liquidity in the mortgage-backed securities sector that are essential to restore the flow of funding for healthy housing and home building markets. The higher returns demanded by investors will translate into higher interest rates for borrowers. Larger down payments are likely to be required, which affects first-time homebuyers particularly. The result for all borrowers is higher costs of homeownership. For the economy, it adds further delay to the recovery of the housing sector and would stifle the stimulus efforts that Congress is undertaking to help avoid recession. For the long-term, H.R. 3609 will take the edge off the growth potential of one of the most important components of national economic growth.

Simply put, all of these changes will add significantly to the risk and costs that a lender faces when making any loan. To cover this risk, the interest rate charged will certainly increase and the willingness to lend to higher-risk, but creditworthy borrowers will decrease. Moreover, since any lender will not know what loans will end up in the bankruptcy process, the rate of interest on ***all*** mortgage

loans – both prime and subprime – will rise. ***This would impose a cost on all homeowners including the vast majority who meet their obligations and never file for bankruptcy.***

It is also worth noting an asymmetry in the process. In a cramdown the creditor takes an irrevocable loss. Once home values start to appreciate again – as they surely will based on historic trends and the demographic realities of new household formation that will drive housing demand over the next decade – the borrower reaps a windfall, but the creditor who suffered the loss does not share in this gain.

The vast majority of economists, mortgage experts, and even the Congressional Budget Office (CBO) believe H.R. 3609 would have an adverse impact on interest rates and credit availability. For example, CBO noted in its analysis of economic stimulus options that one of the costs of the bill "would be higher mortgage interest rates."[2] Professor Joseph Mason of Drexel University testified before the Senate Judiciary Committee that "it is straightforward to conclude" that cram downs will increase the cost of mortgage credit. Professor Mason responded to written questions from the Committee in more detail: "Allowing bankruptcy judges to unilaterally change the terms of a mortgage to those less favorable to the lender will impose unexpected and un-forecastable costs upon lenders and therefore raise the cost of providing funds to borrowers that can qualify for such treatment."

Academic studies also show the costs are real and have an impact on lending. For example, Columbia University professor Charles Calamaris and Drexel University Professor Joseph Mason concluded the following:

> There is concrete evidence of the adverse effects of imposing cram-down on borrowing contracts. In response to increasing agricultural distress in 1978, Congress instituted a temporary provision for mortgage cram-downs for family farmers under Chapter 12 of the Bankruptcy Act. Bankers confirm that Chapter 12

[2] See, CBO Paper – Options for Responding to Short-Term Economic Weakness (January 2008) at 25. http://www.cbo.gov/ftpdocs/89xx/doc8916/Frontmatter.2.1.shtml

> cram-down has indeed made lending to small farmers a substantially riskier proposition, and they consequently have largely withdrawn funds from this business line.
>
> The withdrawal of agricultural lenders took place when family farmers sorely needed capital from all sources. Cram-down radically affects credit allocation and does not support orderly and efficient allocation of resources in bankruptcy. Cram-downs significantly hurt mortgage lending in agriculture in the 1980's. Cram-downs for home mortgage debt would result in the same type of credit contraction witnessed in the agricultural sector.[3]

Moreover, in studying the impact of cramdowns for farm real estate in Chapter 12 bankruptcy, the United States Department of Agriculture (USDA) estimated that cramdowns raise the interest rates on farm real estate loans by 25 basis points to 100 basis points.[4] This means as much as a 10 percent increase in the monthly mortgage payments just because of the uncertainty surrounding the collateral value.

II. H.R. 3609 Will Encourage More Bankruptcies and Discourage Borrowers From Working With Lenders To Facilitate a Resolution

Foreclosure is a losing proposition for all parties. Consumers lose their home while lenders lose money and their customers. For this reason, responsible lenders want to avoid the foreclosure process whenever possible. The industry is already taking positive steps to reach out to troubled borrowers and help them avoid foreclosure. As mentioned at the outset, the HOPE NOW alliance reported that 370,000 homeowners were helped in the second half of last year and that work continues in earnest this year. Individual mortgage lenders and servicers are contacting customers who are behind on their mortgage payments or who may be facing adjustable rate mortgage resets. Through telephone calls,

[3] Calomiris, Charles W. and Mason, Joseph R., "High Loan-to-Value Mortgage Lending: Problem or Cure?" AEI Studies on Financial Market Deregulation, 1999.
[4] "Do farmers Need a Separate Chapter in the Bankruptcy Code?" *Issues in Agricultural and Rural Finance*, United States Department of Agriculture, Economic Research Service, October 1997.

direct mail, e-mail, and interactive web sites, these companies are letting customers know of the various options at their disposal for anticipating and managing the challenges that accompany a mortgage rate reset. These options include affordable refinancing terms and payment plans that will allow borrowers to remain in their homes.

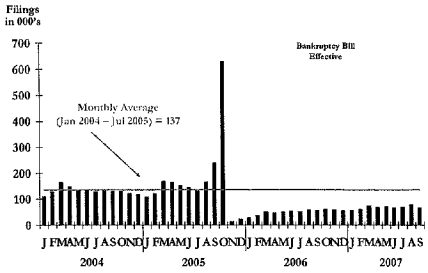
H.R. 3609 would undermine these efforts. Rather than helping to facilitate refinancing or restructuring of mortgage loans to avoid foreclosure, the proposed changes embodied in H.R. 3609 will have the opposite effect by encouraging even more people to take the issue to the courts. In fact, the bill moves the entire bankruptcy system backwards and encourages debtors to use bankruptcy not as a last resort, but as a financial management tool. There is little doubt that if this bill is enacted many debtor attorneys will aggressively advertise that troubled borrowers should ignore market-based refinancing opportunities or mutually agreeable restructuring facilitated by organizations like HOPE NOW.

H.R. 3609 would jam the bankruptcy courts and fosters abuse of the system. CBO's analysis of economic stimulus options states that H.R. 3609 would "add to the caseload of the bankruptcy court system causing delays in resolving cases." Consider, for example, the problem of deciding what the home's fair market value is – a critical decision given the financial magnitude of the potential cramdown. Inevitably, the courts will be asked to referee – and would certainly become mired in – the battles over competing appraisals to determine the market value. Unlike the other avenues to providing relief to troubled borrowers, bankruptcy (like all litigation) is an adversarial process in which debtor counsel will present as evidence the lowest possible appraisal. To the extent that bankruptcy judges accept such "lowball" appraisals in the hundreds of thousands of cases that bill's proponents predict will be filed, they will further destabilize the overall housing market by dragging market valuations lower than they would otherwise be.

H.R. 3609 also creates incentives for increased fraud and abuse in the bankruptcy system. Professor Mason said in his Senate Judiciary Committee testimony that allowing judges to change the terms of mortgages in bankruptcy "sets the stage for a potential abuse of the bankruptcy system to further speculative purposes." He also believes it would encourage people to cash out their home equity, thus dramatically reducing a major component of retirement savings for most Americans.

Bankruptcy provides a fresh start for those that truly need it. This was true before Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and it remains true today. Recognizing that the bankruptcy system had been providing billions of dollars of debt relief without ever questioning whether filers truly needed relief or to what degree, Congress enacted BAPCPA to help restore personal responsibility and integrity to the bankruptcy system. This legislation implemented an objective income/expense test designed to ensure that debtors (who earn more than the median income in their state) who can repay a portion of their debt should be required to do so. BAPCPA also requires debtors to receive credit counseling before they are determined to be eligible for bankruptcy. The purpose behind this provision is to ensure that debtors understand the alternatives to bankruptcy and the consequences of filing for bankruptcy. Debtors that do eventually file for bankruptcy are required to participate in a financial management course prior to receiving their discharge, thus helping them avoid future financial difficulties.

Pre- and Post-Bankruptcy Filing Rates



Source: Administrative Office of the U.S. Courts

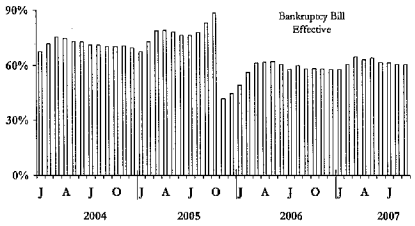
In the two years since BAPCPA became effective, average bankruptcy filings have fallen to roughly half of what they were prior. This is evidence that borrowers are, in fact, employing

alternatives to bankruptcy. It also indicates that debtors are reaching out to lenders to try and negotiate workable repayment plans. Moreover, it suggests that debtors are no longer looking at the bankruptcy system as a financial planning tool and abusing the protections it affords.

The lower number of bankruptcy filings since the law became effective also verifies the notion that many debtors who seek bankruptcy protection actually have the ability to repay at least a portion of their debt. Since enactment of BAPCPA, the share of Chapter 7 bankruptcy filings relative to all filings (in Chapter 13 and Chapter 7) has also declined considerably (see chart on the next page). In the years leading up to enactment of BAPCPA, the share of Chapter 7 filings was nearly 73 percent. Since enactment of the new law, that share has fallen to just over 60 percent.

Effect of Bankruptcy Bill on Chapter 7 Filings

Chapter 7's as a Percentage of Chapter 7's & 13's



Source: Administrative Office of the U.S. Courts

If the current bankruptcy law is altered so that judges are allowed to modify the terms of home mortgages for primary residences in Chapter 13 bankruptcies, the potential for cram-downs, lowered interest rates and over-extended repayment periods will once again allow debtors to use the bankruptcy system as a financial planning tool rather than a tool of last resort. In fact, lawyers for debtors will aggressively advertise that they can significantly reduce mortgage terms for bankruptcy filers. Given that mortgages are the biggest asset for the vast majority of debtors, the promise by lawyers to reduce borrowers' housing payment obligations significantly while still being able to remain in their homes will attract not just those who are truly in need of a fresh start, but others also – including those that are current on their mortgage and "investors" that were attempting to flip houses and now want to be bailed out of a bad investment.

III. Credit Counseling is an Important Component of the Bankruptcy Process

Filing for bankruptcy remains an important avenue for debtors that truly need a fresh start. However, many individuals still do not fully realize that options other than bankruptcy are available to them – including working with lenders to find an appropriate payment plan on the debt. Many bankers have told us that prior to the change in the bankruptcy law, the first time they knew that a borrower was having difficulty was when they received the bankruptcy notice. These banks did not have ample opportunity to address this situation and help the borrower avoid bankruptcy.

The pre-filing counseling requirement has helped reduce the filings and facilitate workouts. While it is too soon to fully know the impact of this requirement, the early indications are the individuals, once they are aware of options, choose a path other than bankruptcy. In fact, the United States Trustee office found that between October 2006 and June 2007, 14 percent of individuals that completed the credit counseling requirement did not end up declaring bankruptcy.

Credit counseling provides an important independent source of information for debtors about the process and can confirm or deny the information provided to them by bankruptcy lawyers (who have a financial incentive to push the individual to file rather than having the debtor work out another solution). Credit counselors are well versed in housing assistance that can help a borrower save his or her home without filing bankruptcy. Many counselors are associated with a HUD-Approved Housing Counseling Agency. Moreover, to the extent that borrowers did not fully understand the terms of the mortgage that they signed, credit counseling can be the first step in helping to educate them about alternative mortgage options, ways to avoid taking on obligations beyond their means, and even to discuss whether owning or renting is more appropriate for their situation.

Thus, eliminating the credit counseling requirement would be against the interest of debtors and lenders. In this regard, the "compromise" version of H.R. 3609 is a giant step backwards from the bill

that was originally introduced. The initial version of H.R. 3609 would only have granted a waiver of the normal pre-filing credit counseling requirement where the debtor had submitted to the court "a certification that the holder of a claim secured by a debtor's principal residence has initiated a judicial or non-judicial foreclosure on the debtor's principal residence." But the reported version has watered down that requirement to "a certification that the holder of a claim secured by the debtor's principal residence *may* commence a foreclosure on the debtor's principal residence (Emphasis added)." In other words, the bill would now provide a blanket exemption from the counseling requirement even where no foreclosure proceeding has even commenced. We have no idea what the courts would rule sufficient to trigger this exemption – but we have no doubt that debtor attorneys will argue that any notice from the claim holder regarding a past due amount, or even the original mortgage document setting forth the lender's right to foreclose, is sufficient to trigger this exemption. The fact that the bill now requires the counseling to be completed within 30-45 days after the debtor has initiated a bankruptcy proceeding is irrelevant, because at that point the die has been cast and the adversarial process has commenced. We can understand why the debtor bar supports a blanket counseling exemption that will result in many debtors learning, too late, that they had viable non-bankruptcy options for addressing their housing finance problems – but we cannot understand why Congress would provide such a blanket exemption where foreclosure proceedings have not even been initiated.

In any event, there is no need for any such exemption as the Bankruptcy Code (Section 109) already allows judges to waive the counseling requirement for "exigent circumstances" where the debtor has sought counseling from an approved non-profit counseling agency but was unable to receive such assistance within five days. Moreover, there is ample time between the initiation and conclusion of a foreclosure action to receive the required counseling and make a fully informed decision about whether bankruptcy is the only viable option for a particular borrower.

Conclusion

Lenders are currently working to help individuals that are experiencing difficulties meeting their mortgage payments, or will have difficulties when their adjustable mortgages reset to higher interest rates. However, should this bill be enacted, it will be much more difficult to work with borrowers to do this and it will make it harder for people to obtain new loans or to refinance their existing mortgages. Interest rates will be higher and underwriting will be tightened, making it difficult to qualify for new loans, particularly for those borrowers with lower incomes, weaker credit and smaller downpayments -- just the opposite of what is needed in today's market. Simply put, H.R. 3609 would undermine the effectiveness of Congressional and private-sector housing-related initiatives and restrict credit at a time when an economic stimulus is needed to avoid recession.

Rather than introduce tremendous new uncertainty into the mortgage markets by eroding the value of collateral in the bankruptcy process, Congress should instead work to bring non-bank mortgage lenders up to the standards already in place for the banking industry. The ABA – and all our member banks – wants to be part of the solution and we stand ready to work with this Committee to effect positive change.

LETTER IN OPPOSITION OF H.R. 3609, THE "EMERGENCY HOME OWNERSHIP AND MORTGAGE EQUITY PROTECTION ACT"

Oppose H.R. 3609, the Emergency Home Ownership & Mortgage Equity Protection Act

Bill Would Lead to More Bankruptcies, More Foreclosures, and Higher Mortgage Rates

Dear Representative:

The undersigned organizations, representing a united lending industry, are writing in opposition to H.R. 3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007. This legislation, which was reported by the Judiciary Committee late last year, would add significant risk and uncertainty to the housing market by making major changes in our bankruptcy system. H.R. 3609 would undermine the effectiveness of Congressional and private-sector initiatives to help current and future homeowners and further restrict credit at a time when every effort possible is being made to stimulate the economy and avoid a recession. We strongly urge you not to cosponsor this harmful bill and to oppose it if it comes to the House floor.

H.R. 3609 would allow bankruptcy judges for the first time to alter the terms of a mortgage on a primary residence. For instance, judges would be allowed to make a unilateral decision to reduce ("cram down") the amount owed to a lender. Historically, this was prohibited because it would undermine the long-standing public policy to encourage liquidity in the mortgage market and increase home ownership. Specifically, when Congress rewrote the bankruptcy laws in 1978, it deliberately retained the prohibition on cram downs and other changes to first mortgages by bankruptcy judges to keep housing affordable for as many Americans as possible. To change this policy now, especially when the country is facing a highly volatile and uncertain housing market, is bad public policy and would have several negative consequences for current and future homeowners, the housing market, and the economy.

Allowing bankruptcy judges to unilaterally change mortgage terms would increase risks for lenders and result in increased borrowing costs and less credit availability. At a time when the credit market is already contracting, this is the opposite of what is needed. The Mortgage Bankers Association (MBA) estimates that H.R. 3609 could increase interest rates on first mortgages by at least 1.5 percent. MBA has provided an online calculator for borrowers to determine what this would mean for them.[1]

For example, in Los Angeles County, the cost of an average $359,000 mortgage would increase more than $4,200 per year. In Wake County, North Carolina, an average $160,000 mortgage would increase more than $1,900 per year. And in Hamilton County, Ohio, the cost of an average $132,000 mortgage would increase more than $1,500 per year. Many deserving borrowers simply cannot afford these increased costs.

The vast majority of economists, mortgage experts, and even the Congressional Budget Office (CBO) believe H.R. 3609 would have an adverse impact on interest rates and credit availability. For example, CBO noted in its analysis of economic stimulus options that one of the costs of the bill "would be higher mortgage interest rates."[2] Professor Joseph Mason of Drexel University testified before the

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[1] Go to: http://www.mortgagebankers.org/StopTheCramDown

[2] See, CBO Paper – Options for Responding to Short-Term Economic Weakness (January 2008) at 25. http://www.cbo.gov/ftpdocs/89xx/doc8916/Frontmatter.2.1.shtml

Senate Judiciary Committee that "it is straightforward to conclude" that cram downs will increase the cost of mortgage credit. Professor Mason responded to written questions from the Committee in more detail: "Allowing bankruptcy judges to unilaterally change the terms of a mortgage to those less favorable to the lender will impose unexpected and un-forecastable costs upon lenders and therefore raise the cost of providing funds to borrowers that can qualify for such treatment."

Lenders want to avoid foreclosures whenever possible, and government and private-sector efforts to work with borrowers to avoid foreclosure are starting to take hold. For example, a recent study of 28,000 "non-traditional" mortgages held by banks and credit unions as of August 2007 conducted by California's Department of Financial Institutions showed that a minority of these loans (9 percent) were delinquent 90 or more days or in foreclosure and that most of these were being worked-out rather than foreclosed upon (about 450 foreclosures to 3,500 workouts).[3] Statistics compiled by MBA show that nearly a quarter of a million loans were put into repayment plans or modified in the third quarter of 2007. On January 18, the HOPE NOW alliance of counselors, lenders, and servicers reported that 370,000 homeowners were helped in the second half of 2007 through repayment plans and workouts, and that the number of borrowers being helped "is accelerating rapidly."

H.R. 3609 would undermine work out efforts because it encourages borrowers to file for bankruptcy first, rather than viewing bankruptcy as a last resort. CBO's analysis of economic stimulus options states that H.R. 3609 would "add to the caseload of the bankruptcy court system causing delays in resolving cases." There is also real concern that H.R. 3609 would result in increased fraud and abuse in the bankruptcy system. Professor Mason said in his Senate Judiciary Committee testimony that allowing judges to change the terms of mortgages in bankruptcy "sets the stage for a potential abuse of the bankruptcy system to further speculative purposes." He also believes it would encourage people to cash out their home equity, thus dramatically reducing a major component of retirement savings for most Americans.

We strongly urge you not to cosponsor H.R. 3609 and to oppose it if it comes to the House floor. H.R. 3609 would undermine the effectiveness of Congressional and private-sector housing-related initiatives, while hurting millions of current and prospective homebuyers and the economy.

American Bankers Association
American Financial Services Association
American Securitization Forum
Consumer Bankers Association
Consumer Mortgage Coalition
Independent Community Bankers of America
Mortgage Bankers Association
National Association of Home Builders
Securities Industry and Financial Markets Association
The Financial Services Roundtable
The Housing Policy Council
U.S. Chamber of Commerce

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[3] See, http://www.dfi.ca.gov/publications/bulletins/2007/november07.pdf

DEAR COLLEAGUE LETTER FROM THE CHAIRMAN AND RANKING MEMBER OF THE COMMITTEE ON FINANCIAL SERVICES

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May 18, 2007

Dear Colleague:

As you know, serious problems have appeared in the mortgage sector in recent months, particularly with subprime loans. As adjustable rate mortgages reset to higher rates, some borrowers are finding themselves unable to meet their new monthly payments, and may be in danger of losing their homes to foreclosure.

The Financial Services Committee has worked to encourage lenders, community groups, and others to anticipate the needs of borrowers in financial distress and avert as many foreclosures as possible. One resource for assisting these borrowers is a national hotline developed by the Homeownership Preservation Foundation, NeighborWorks America, and the Housing Policy Council of the Financial Services Roundtable.

This toll-free hotline – 888-995-HOPE – is available to consumers in all 50 states, 24 hours a day, seven days a week. It offers counseling for borrowers in need from independent, non-profit counselors approved by the Department of Housing and Urban Development, who will work with borrowers and their lenders to find solutions for problem mortgage situations. The Ad Council will be launching a national advertising campaign for the hotline beginning June 25.

The hotline is one of many resources available to distressed homeowners, and we wanted to bring it to your attention as a tool for you and your staff to help answer constituent inquiries about these issues.

Sincerely,

BARNEY FRANK
Chairman

SPENCER BACHUS
Ranking Member

United States. Congress. Senate. Committee on the Judiciary. Subcommittee on...

S. HRG. 102-324

CRAMDOWNS OF RESIDENTIAL REAL ESTATE MORTGAGES IN CHAPTER 13 BANKRUPTCIES

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HEARING

BEFORE THE

SUBCOMMITTEE ON
COURTS AND ADMINISTRATIVE PRACTICE
OF THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
ONE HUNDRED SECOND CONGRESS
FIRST SESSION
ON

THE IMPACT OF COURT DECISIONS WHICH HAVE ALLOWED "CRAMDOWNS" OF RESIDENTIAL MORTGAGE LOANS UNDER CHAPTER 13 OF THE BANKRUPTCY CODE

JUNE 6, 1991

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STATEMENT OF FRANK KEATING, GENERAL COUNSEL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC, ACCOMPANIED BY ROBERT P. KALISH, EXECUTIVE VICE PRESIDENT, AND GUY S. WILSON, VICE PRESIDENT, MORTGAGE-BACKED SECURITIES

Mr. KEATING. Thank you, Mr. Chairman.

Mr. Chairman, I have a formal statement I would like to provide for the record, and for my remarks I have a shortened form of that, if I could read it at this time.

As introduced, I am Frank Keating, the general counsel at HUD, and I am accompanied today by Mr. Bob Kalish, to my right, the executive vice president of GNMA, and Guy Wilson, to my left, GNMA's vice president for Mortgage-Backed Securities.

As the subcommittee is aware, GNMA is a wholly owned Government corporation within HUD. It guarantees the timely payment of principal and interest on privately issued investment securities that are backed by pools of FHA-insured or VA-guaranteed mortgages. GNMA principal mission is to support the Government's housing objectives by establishing secondary markets to channel funds from the securities market into the mortgage market, thereby increasing the supply of credit available for housing.

Under the GNMA mortgage-backed securities program, issuers are responsible for collecting principal and interest payments from borrowers and passing these payments, plus any shortfall, through to the GNMA investors. Payments to the investors are based on the initial principal balance and the stated coupon rate of the securities, which is further correlated to the interest rate on the underlying mortgages.

I would say, Mr. Chairman and Senator Grassley, that we have Mr. Wilson available here for any explanation of this process, and he even has a series of panels to show the subcommittee on how the process works.

The issuers in the GNMA program hold the underlying mortgage documents and are compensated for servicing the loans to a greater extent than are FNMA or FHLMC because they are required to pass through full monthly payments to investors regardless of whether or not they receive such payments from the mortgagors.

As we at HUD understand the cramdown process as it relates to the interpretations made in chapter 13 bankruptcies, the mortgagor-debtor is allowed to restructure certain debts over the objection of the creditor-mortgagee. This entails reducing the mortgage obligation to the approximate current value of the real property. The difference between the previously secured portion of the property and the court's determination of the secured portion is relegated to unsecured status, which provides for payment along with claims of all other unsecured creditors. This often means little or no payment to the mortgagee on the newly unsecured portion of the mortgage once the plan is completed. Such action by the court, however, does not relieve the mortgagee, which also happens to be a GNMA issuer in this case, from its obligation to make passthroughs of all required principal and interest to the investors in the mortgage-backed security.

GNMA is concerned, as is HUD, that the potential widespread practice of this form of debt relief could be extremely detrimental to the overall effectiveness of its chartered responsibility of increasing the supply of mortgage credit for potential home buyers who qualify under the FHA or VA programs. GNMA and HUD are especially concerned that if cramdowns become more widespread, the lending community might be reluctant to lend to individuals, or possibly in certain communities arbitrarily determined to be areas of potential cramdown risk. I would also like to point out that if depressed property values recover after conclusion of the chapter 13 plan, there is no mechanism to increase the amount of the mortgage lien. In this case, the mortgagor would benefit from a windfall at the expense of the issuer.

The ramifications of this scenario regrettably are real. Both FHA and VA have adopted the position that claims would be paid only on the secured indebtedness as it may have been reduced by the court. GNMA has determined, based on the contractual obligations it has with its issuers, that the issuers are responsible for the shortfall in principal due the GNMA investors caused by the cramdown. Furthermore, GNMA has determined that the payment differential—or to put it another way, the unsecured portion of the mortgage debt—is due upon the bankruptcy discharge. This means that not only would the GNMA issuer lose the payments from the mortgagor representing the unsecured portion of the debt, but upon discharge of the chapter 13 plan, the issuer must pass through this now unsecured portion of the debt to the investors in the mortgage-backed security. The issuer is required to advance these funds from its capital to keep the mortgage-backed security in balance with the underlying secured loan backing that security.

The impact to the GNMA issuer community and, therefore, GNMA could be devastating if the cramdown alternative is readily available as a form of mortgage abatement. With the issuer responsible for the principal shortfall, an intense and long-lived negative cash flow could cause the issuer to run out of available capital and default on its obligations to GNMA. In this situation, GNMA becomes responsible for the obligations to the investors. Moreover, GNMA has a direct risk that cramdowns will be imposed on its own defaulted portfolio obtained through the prior defaults of GNMA issuers.

While the current risk is minimal since the slide of property values in various parts of the country has significantly abated, the opportunity for swift losses in an unexpectedly severe economic downturn in one or more regions of the country could have a material impact on the financial stability of numerous GNMA issuers. In turn, each defaulted GNMA issuer would constitute a drain on the resources of GNMA.

In order to avoid such an adverse scenario, the Department strongly recommends that Congress further clarify the intent of the bankruptcy law. We believe that chapter 13 cramdowns of a mortgage secured by real property that is the debtor's principal and personal residence should not be allowed.

Mr. Chairman, that concludes my oral remarks. I will be happy to respond to any questions.

Senator HEFLIN. Will you give us some type of perspective as to how large a problem cramdowns are in the housing marketplace? How many occur and do you have a dollar figure valuation as to how much money is involved in these cramdowns? Generally, would you tell us the scope of this problem in relationship to the overall housing market?

Mr. KEATING. Mr. Chairman, that is difficult to say from HUD's perspective at this time, because many of these chapter 13 plans, as the chairman knows, are from 3 to 5 years before they are resolved. In the case of a cramdown that is a part of that plan, we won't know until after that process whether or not there has been a default, whether or not there has been a foreclosure, whether or not there has been a payment or a requirement for a payment.

At this time, as a result of the fact that these circuit opinions in the third, ninth, and tenth circuits are only a few years old, we don't have any large-scale experience of loss. But it is my colleagues' positions here—and I would ask Mr. Kalish to respond in more detail—that it could be and we expect will be a significant problem. But we do not have the exact dollar amounts because we have had little experience.

Mr. Kalish?

Mr. KALISH. To date, as Mr. Keating stated, the losses at GNMA are minimal. It is the prospective losses that really concern us. GNMA has its own portfolio acquired from defaulted issuers in the amount, single family, of approximately $10 billion. We are getting reports from our contractors, whom we call subservicers, who service those loans on our behalf, those pools, that the cramdown problem is escalating and is becoming quite serious.

As to the dollar amount yet, as Mr. Keating indicated, since it takes such a long time for the plan to be implemented, 3 to 5 years, we just do not have a firm focus on the dollar as yet.

Senator HEFLIN. Well, is the problem that you describe in cramdown simply a function of a depressed real estate market? And as the American economy turns around, will we see this problem go away?

Mr. KEATING. Well, Mr. Chairman, obviously it is hoped that part of the problem is the result of a depressed real estate market, and as the market firms up, the problem will abate. However, we are concerned about the philosophy of permitting a mortgagor on a mortgage for his principal and personal residence, in the course of attempting to solve his financial problems, to in effect—though the mortgage amount remains the same, the monthly payment remains the same—receive a possibility of a very significant windfall as a result of the cramdown. So that after the market improves, for example, when potentially the issuers are having a severe problem paying GNMA or if they go bankrupt and GNMA, of course, is using its funds to pay the payments due on the GNMA securities, if the market turns around you have the prospect of having a mortgagor receiving a significant windfall from the cramdown transaction.

So we are concerned about the equity of that, notwithstanding the fact that we hope that as the market improves the situation will not remain as grave.

Senator HEFLIN. In your written statement, you note, "We believe that chapter 13 cramdowns of a mortgage secured by real property that is the debtor's principal residence should not be allowed." Does your position extend to all secured mortgages including second and third mortgages? Or is your position limited to the primary or initial purchase money security interest mortgage?

Mr. KEATING. We think that the same rules, the same problem, and the same resolution would apply to all three, whether it is first, second, or third mortgages on principal residence.

Senator HEFLIN. Does a reading of the statute allow for secondary mortgages under the decisions of these courts to fall in the same position as the primary mortgage?

Mr. KEATING. Mr. Chairman, I don't know if that has been addressed by the courts. Again, our experience has been very limited in this area.

I know that there are some courts that have permitted this type of transaction to occur in chapter 7 bankruptcies, as well as the wage-earner plans in chapter 13. But whether or not—I don't think we have had any experience in other mortgage transactions, and I don't know if the courts address those.

Senator HEFLIN. How do you respond to the criticism that in the realities of a chapter 13 bankruptcy, a mortgage holder whose claim is bifurcated into secured and unsecured portions is actually in a better fiscal position, because if the individual in the chapter 13 was simply to liquidate their assets under a chapter 7 proceeding, the mortgagor would simply receive the property and have no claim on other assets as an unsecured creditor, to the extent that the fair market value of the real estate was less than the debt owed under the mortgage?

Mr. KEATING. Well, first, Mr. Chairman, I would say that it would be the Department's position and I know GNMA's position that the plan should be consistent with the statute. And we think the clear intent of Congress in 1322(b)(2) is to permit modification of the rights of holders of secured claims other, as the statute says, "than a claim secured only by security interest in real property that is the debtor's principal residence." We think that that language is clear and unambiguous, that notwithstanding the fluctuations in the market value of the home, the security and the debt underlying the security remain constant.

We think that because of the fluctuation in market values, what one day may be a shortfall and a difficulty for the homeowner debtor may the next day be a significant windfall. We find that troubling.

We would also note that in the cramdown, the chapter 13 cramdown, third, that the mortgagor's monthly payment isn't affected at all. It is just the corpus or the principal amount of the mortgage debt that remains. So he is given truthfully very little relief. Generally his problem, the reason he goes into chapter 13 bankruptcy to start with, is because he has difficulty making his monthly payments. That is not affected by the chapter 13 cramdown or the chapter 13 wage-earner's plan.

Senator HEFLIN. I will ask this question. I had it raised to me, but a question arises in my mind, and with other witnesses I may ask them if they want to address it. Is there another way other

than a change of this language, such as contractual language in a mortgage, that takes care of this, or on the other hand some type of an indemnity that could be written as an adjunct to title insurance or some other aspect that would cure this problem in regards to those places where you might bifurcate this matter into secured and unsecured creditors? Could it be handled under a contract document? If not, could it be handled by some type of indemnification?

Mr. KEATING. Before we get into the indemnification issue—and perhaps Guy Wilson, the vice president of GNMA, could handle that—I might point out, Mr. Chairman, that obviously it may well be the position of a district court or, as in the case of at least three circuits, a circuit court that notwithstanding what you may wish to do by contract, you cannot by contract amend a statute. And if it is the position of the court that the statute is clear permitting this process, then I think it would be rather difficult for the parties to be able to rely on a contract that the court could set aside.

But let me see if Mr. Wilson would want to discuss the indemnity issue.

Mr. WILSON. Mr. Chairman, I am not aware of any way—I agree with Mr. Keating—that, in fact, generally the courts would I think hold it against public policy to have a mortgage provision that would prevent them from cramming down a mortgage if they so chose.

On the part of the question concerning title insurance, that would be a new form, I think, of title insurance. It could——

Senator HEFLIN. I just thought it might be a separate policy, the issue of indemnity which gives to the mortgagee might be some way to address this issue.

Mr. WILSON. It is possible to write. I would imagine it would be something that the insurance industry would have to take up, but I am not aware of a provision like that currently. And I would think that it might be fairly expensive.

Senator HEFLIN. Do you think a contractual basis, in just looking at language and thinking about the possibility of language in a mortgage, where it in effect states the amount that an individual applies for and appraised value constitutes an indemnification, is an answer I was just thinking out loud.

Mr. KEATING. Well, as I have indicated, Mr. Chairman, our concern is to provide liquidity to the secondary mortgage market to encourage the lending of money, especially in the price range that we are talking about, the FHA-VA price range. And if an issuer is afraid that he is going to be called upon to pay, let's say, half of the principal due on a mortgage if that mortgagor files a chapter 13 plan and half of the mortgage is discharged as unsecured, then he may not be willing to be an issuer. He may not be willing to get in the business of dealing with GNMA. As a result, I think it would be a considerable potential blow to the housing market.

We think on a long-term basis this could be a very serious problem.

Senator HEFLIN. Thank you.

Senator Grassley, I didn't call on your for an opening statement, but go ahead and give it and ask your questions, and then we will do the same with Senator Thurmond.

Testimony of

Frank Keating
General Counsel
U.S. Department of Housing and Urban Development

before the
Senate Subcommittee on Courts and Administrative Practice

on
Cramdowns of Residential Real Estate Mortgages
in Chapter 13 Bankruptcies

June 6, 1991

The Department of Housing and Urban Development (HUD) appreciates the opportunity to express the views of the Government National Mortgage Association (GNMA) on cramdowns of residential mortgages stemming from Chapter 13 bankruptcies. My name is Frank Keating, General Counsel at HUD and I am accompanied here today by Robert P. Kalish, Executive Vice President, GNMA, and Guy S. Wilson, GNMA's Vice President, Mortgage-Backed Securities.

GNMA is a wholly-owned government corporation within the Department of Housing and Urban Development. GNMA guarantees the timely payment of principal and interest on privately-issued investment securities that are backed by pools of FHA-insured or VA-guaranteed mortgages. GNMA's principal mission is to support the Government's housing objectives by establishing secondary markets to channel funds from the securities market into the mortgage market, thereby increasing the supply of credit available for housing.

Under the GNMA mortgage-backed securities program, issuers are responsible for collecting principal and interest payments from borrowers and passing these payments PLUS ANY SHORTFALL (e.g. amounts not received from mortgagors) through to the GNMA investors. Payments to the investors are based on the initial principal balance and the stated coupon rate of the securities,

which is further correlated to the interest rate on the underlying mortgages. Unlike the respective mortgage-backed securities programs of the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), GNMA does not hold the mortgages in trust; rather, GNMA serves only as a guarantor of the timely payment of principal and interest by the issuers. The issuers, in the GNMA program, hold the underlying mortgage documents and are compensated for servicing the loans to a greater extent than are FNMA and FHLMC program participants because they are required to pass-through full monthly payments to investors regardless of whether or not they receive such payments from the mortgagors.

As we understand the cramdown process as it relates to interpretations made in Chapter 13 bankruptcy proceedings, the mortgagor (debtor) is allowed to restructure certain debts over the objection of the mortgagee (creditor). This entails reducing the mortgage obligation to the approximate current value of the real property. The difference between the previously secured portion of the property and the court's determination of the secured portion is relegated to unsecured status, which provides for payment along with claims of all other unsecured creditors. This often means little or no payment to the mortgagee on the newly unsecured portion of the mortgage. Such action by the court, however, does NOT relieve the mortgagee, which is also the GNMA issuer, from its obligation to make pass-throughs of all required principal and interest to the investors in the mortgage-backed security.

GNMA is concerned that the potential widespread practice of this form of debt relief could be extremely detrimental to the overall effectiveness of its chartered responsibility of increasing the supply of mortgage credit for potential homebuyers who qualify under the FHA or VA programs. GNMA is especially

concerned that, if cramdowns become more widespread, the lending community might be reluctant to lend to individuals, or possibly in certain communities arbitrarily determined to be areas of potential cramdown risk. I would like to also point out that if depressed property values recover after conclusion of the Chapter 13 plan, there is no mechanism to increase the amount of the mortgage lien. In this case, the mortgagor would benefit from a windfall at the expense of the issuer.

The ramifications of this scenario are real. Both FHA and VA have adopted the position that claims would be paid only on the secured indebtedness as it may have been reduced by the court. GNMA has determined, based on the contractual obligations with its approved issuers, that the issuers are responsible for the shortfall in principal due the GNMA investors caused by a cramdown. Furthermore, GNMA has determined that the payment differential--or to put it another way, the unsecured portion of the mortgage debt--is due upon the bankruptcy discharge. This means that not only would the GNMA issuer lose the payments from the mortgagor representing the unsecured portion of the debt, but upon discharge of the Chapter 13, the issuer must pass-through this now unsecured portion of the debt to the investors in the mortgage-backed security. The issuer is required to advance these funds from its capital to keep the mortgage-backed security in balance with the underlying secured loan backing that security.

The impact to the GNMA issuer community and, therefore, GNMA could be devastating if the cramdown alternative is readily available as a form of mortgage abatement. With the issuer responsible for the principal shortfall, an intense and long-lived negative stream of cash outlays could cause the issuer to run out of available capital and default on its responsibilities to GNMA. In this situation, GNMA becomes responsible for the

obligations to the investors. Moreover, GNMA has a direct risk that cramdowns will be imposed on its own defaulted portfolio obtained through the prior defaults of GNMA issuers.

While the current risk is minimal since the slide of property values in various parts of the country has significantly abated, the opportunity for swift losses in an unexpectedly severe economic downturn in one or more regions of the country could have a material impact on the financial stability of numerous GNMA issuers. In turn, each defaulted GNMA issuer would constitute a drain on the resources of GNMA.

In order to avoid such an adverse scenario, the Department strongly recommends that Congress further clarify the intent of the bankruptcy law. We believe that Chapter 13 cramdowns of a mortgage secured by real property that is the debtor's principal residence should not be allowed. The courts permitting cramdowns have applied Section 506(a) of the Bankruptcy Code to Section 1322(b)(2) which reads, "the plan [proposed by the debtor] may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence." Under this interpretation, courts divide the secured claim into a secured portion and an unsecured portion, resulting in a reduction in the amount of the mortgage lien. We do not feel such a division--and the resulting cramdown--is consistent with Section 1322(b)(2) and, therefore, should not be allowed.

I would like to thank you for the opportunity to express the Department's views on this subject and I will be happy to answer any questions members of the Subcommittee may have.

Mr. CANNON. And with that, I would yield back in the hopes that we have a hearing that moves very quickly. This is the biggest panel, I think, we have ever had, or had in the last 12 years. And hopefully, we can move through it quickly.

Thank you, Madam Chair. I yield back.

Ms. SÁNCHEZ. I thank you, Mr. Chairman.

And at this time I would now like to recognize the distinguished Chairman of the full Committee, Mr. Conyers, for an opening statement.

Chairman CONYERS. Thank you very much.

The reason the panel is so large, Mr. Cannon, is that the subject matter is so complex and requires at least this many people, and maybe more. And I want to thank you very much for having been with us on all of this.

And I want to thank the Ranking Member as well, Lamar Smith, for allowing us at the last moment to join Subcommiee Chair Sánchez and I in inviting James Carr to be added to the already lengthy panel.

I am always happy to see all my friends here, starting with the person who probably doesn't need universal health care, although he has a bad cold, Jack Kemp. Our days go back to the Martin Luther King era and the struggles that we had congressionally, which I will never forget. Wade Henderson, leading the Leadership Conference on Civil Rights, and all of the rest of you.

I was just in Detroit over the last weekend, at Wayne State University, where we had this same kind of hearing, and because of James Carr's presentation, I was so pleased that the minority would join the Chair and I to invite him to this hearing. And he was able to make it, after changing his schedule.

Now, we are working on a stimulus package. A stimulus package is like taking a garden hose to a 10-alarm fire and wondering why we aren't winning the battle. And there are lots of good things in it and it is well intended—maybe it will send a signal and all that.

But what this is—the problem, as I see it—is that we are dealing with a subject matter that has more potential cumulative financial damage than all the problems of the Great Depression in 1929, plus all of the financial dislocations that we have seen in the "dot com" bubble, and the scandals of Enron, Adelphia, WorldCom and others.

Here this little adjustable mortgage rate problem is now shaking world markets globally, not just on Wall Street. This thing is moving with far deeper implications than any of us could imagine.

Now, as usual we congratulate people who are putting on bandaids and have been trying to do the best they can. And it is not the job or the jurisdiction of this Committee to go into the entire depth of the financial dislocation that is going on, but the biggest problem is not to recognize that it is there.

And so it is in that spirit that I am so proud that this little old Subcommittee number five in Judiciary, which gets all the heavy lifting of the whole Judiciary Committee, is once again saddled with this huge responsibility. And I am very proud that all of you could come and lend your talent and that all of our Committee—Cannon has never seen so many witnesses; I have never seen so many Members at a Subcommittee hearing before.

Thank you very much.

Mr. CANNON. So much for the hope, Mr. Chairman, of a quick hearing. [Laughter.]

Ms. SÁNCHEZ. I thank the distinguished Chair of the full Committee for his opening statement.

And I would now at this time like to recognize Mr. Smith, the distinguished Ranking Member of the full Committee, for his statement.

Mr. SMITH. Thank you, Madam Chair.

Before I make my statement, I, too, would like to recognize our former colleague and a former vice presidential candidate, Jack Kemp, who is here today. I regret that on this particular issue we are not on the same side, which also reminds me that I might have missed an opportunity yesterday when our Chairman called and wanted to add a friend as a new witness today, Mr. James Carr. I should have asked that we dropped a witness at the same time, but I missed my chance. But nevertheless, I appreciate someone with his credibility and stature testifying today, Jack Kemp.

Madam Chair, when the Committee last looked at subprime mortgages, the Administration and Congress had recently undertaken several initiatives to address the growing concern surrounding this issue.

The secretary of treasury's plan, or HOPE NOW, had just been announced. The House had passed bipartisan tax relief to help homeowners benefit fully from debt forgiveness. The Federal Housing Administration's Secure program was taking hold, increasing FHA's flexibility to offer refinancing. And we had passed legislation to modernize the FHA, Fannie Mae and Freddie Mac.

Against that backdrop it was clear that we needed to allow time for these measures to work before considering the dramatic step of rewriting key longstanding terms of the bankruptcy code. There continue to be developments we should monitor.

The HOPE NOW program appears to be gathering a considerable head of steam. It is already making good on its promise to help troubled homeowners. The subprime mortgage crisis, meanwhile, has touched off instability, not only in our markets, but around the globe. Fears of recession in our economy have heightened.

Key policymakers are responding to these broader economic developments. The message from Fed Chairman Ben Bernanke has been that what the economy needs to do to hold off a further downturn is liquidity, liquidity, liquidity.

A group of bipartisan leaders in the House of Representatives and the Administration have negotiated an economic stimulus package based on similar principles. The stimulus is designed to inject liquidity into the market immediately. This directly responds to the housing crisis by increasing the lending flexibility of the FHA, Fannie Mae and Freddie Mac.

One thing, though, hasn't changed since we last met. That is the law of economics. What they told us then, they tell us now. Turning existing primary residence mortgage contracts into bankruptcy will inevitably contract liquidity. Mortgage interest rates will rise. Other lending terms will become more restrictive. Lending will decrease. New homeowners and those who can still refinance will be

hesitant to do so, although it is their home related spending that we desperately need to fuel our economy.

It is precisely the opposite of what the market needs. It is the economic equivalent of throwing cold water on a freezing man. It will undercut the Paulson plan. It will undercut the stimulus package. It will undercut FHA reform. It will undercut our economy.

So again, we should refrain from making changes to the bankruptcy laws. Other better measures are taking hold. The stimulus package will soon add to that hold. Our legislative efforts must strengthen the housing market, not weaken it.

I look forward to hearing from all of today's witnesses.

And, Madam Chair, before I yield back the rest of my time, I do want to say to the Chair that several Members may be leaving almost immediately to go to the House floor for consideration of the FISA bill that we are considering there as well. And I yield back. Thank you.

Ms. SÁNCHEZ. I thank the gentleman.

Without objection, other Members' opening statements will be included in the record. And without objection, the Chair will be authorized to declare a recess at any point in the hearing.

I am now pleased to introduce our distinguished witnesses for today's panel.

Our first witness is Jack Kemp. Mr. Kemp is the founder and chairman of Kemp Partners, a strategic consulting firm helping clients achieve both business and public policy goals.

Mr. Kemp was the Republican Party's vice presidential candidate for the 1996 campaign. From 1989 to 1993, Mr. Kemp served as Secretary of Housing and Urban Development, and before his appointment to the cabinet, he represented the Buffalo area and western New York in the United States House of Representatives from 1971 to 1989.

Mr. Kemp spent 13 years in professional football, playing quarterback for the San Diego Chargers and the Buffalo Bills. He cofounded the AFL Players Association and was elected president for five terms. Mr. Kemp served on the board of Habitat for Humanity and is chairman of Habitat's National Campaign for Rebuilding our Communities.

We want to welcome you here, Mr. Kemp, especially in light of the fact that you are not feeling well.

Our second witness is Wade Henderson. Mr. Henderson is the President and CEO of the Leadership Conference on Civil Rights, LCCR, and counsel to the Leadership Conference on Civil Rights Education Fund. The LCCR is the Nation's premier civil and human rights coalition.

Mr. Henderson is well known for his expertise on a wide range of civil rights, civil liberties and human rights issues. Since taking the helm of the LCCR in June 1996, Mr. Henderson has worked diligently to address emerging policy issues of concern to the civil rights community and to strengthen the effectiveness of the coalition.

Prior to his role with the Leadership Conference, Mr. Henderson was the Washington Bureau Director of the National Association for the Advancement of Colored People, the NAACP. In that capac-

ity he directed the governmental affairs and national legislative program of the NAACP.

Mr. Henderson was previously the Associate Director of the Washington national office of the American Civil Liberties Union, the ACLU, where he began his career as a legislative counsel and advocate on a wide range of civil rights and liberties issues.

Mr. Henderson also served as executive director of the Counsel on Legal Education Opportunities, CLEO. Mr. Henderson is the Joseph L. Rauh, Jr., Professor of Public Interest Law at the David Clarke School of Law of the University of the District of Columbia and the author of numerous articles on civil rights and public policy issues.

Welcome, Mr. Henderson.

Our third witness is David Kittle. Mr. Kittle is chairman elect of the Mortgage Bankers Association and president and chief executive officer of Principle Wholesale Lending, Incorporated, in Louisville, Kentucky.

He started with the American Fletcher Mortgage Company and became the top loan originator before moving to management in 1986. In 1984, Mr. Kittle opened his own company, Associates Mortgage Group, Incorporated, and sold it in January of 2006.

He is a former chairman of MORPAC, MBA's political action committee, a former vice chairman of the MBA residential board of governors, and is a member of MBA's advisory committee. Mr. Kittle is also a member of the Fannie Mae advisory council.

Welcome, Mr. Kittle.

Our fourth witness is Faith Schwartz. Ms. Schwartz is the executive director of HOPE NOW Alliance, a coalition of nationwide servicers, lenders, investors, counselors and other mortgage market participants working together to help owners in distress. Ms. Schwartz previously served as HOPE NOW's project manager.

Prior to joining HOPE NOW, she was senior vice president of enterprise risk and public affairs at Option One Mortgage Corporation, a subsidiary of H&R Block, Incorporated. Ms. Schwartz has also served as the chair of the Mortgage Banking Association's nonconforming credit committee in both 2005 and 1996.

Prior to joining Option One Mortgage Corporation, Ms. Schwartz was director of sales national lending for Freddie Mac. From 1995 to 1997, Ms. Schwartz was chief operating officer for Fieldstone Mortgage Company. She was also executive vice president at TMC Mortgage Corporation from 1991 to 1995.

Ms. Schwartz began her mortgage banking career at Dominion Bankshares Mortgage Corporation in 1983, where she served as vice president of secondary marketing for wholesale purchase programs.

We want to welcome you, Ms. Schwartz.

And you guys are a little bit out of order, but I would like to introduce our fifth witness, Mr. Mark Zandi.

Dr. Zandi is the chief economist and co-founder of *economy.com,* which provides economic research and consulting services to corporations, governments and institutions, maintaining one of the largest online databases of economic and financial time series.

Dr. Zandi's recent work includes the study of the outlook for national and regional housing market conditions, the determinants of

personal bankruptcy, the location of high technology centers, and the impact of globalization and technological change on real estate markets.

In addition to being regularly cited in *The Wall Street Journal, The New York Times, Business Week, Fortune* and other leading publications, Dr. Zandi also appears on ABC News, Wall Street Week, CNN and CNBC.

Welcome, Dr. Zandi. Nice to have you here in person.

Our sixth witness is John Dodds. Mr. Dodds has been the director of the Philadelphia Unemployment Project since its founding in 1975. The Philadelphia Unemployment Project, PUP for short, is both a membership organization and an advocacy organization for the unemployed and low wage workers.

PUP has focused on preventing mortgage foreclosures since the recession of 1981-82 and has been a leading advocate for programs and policies to help preserve homeownership. Its sister organization, the Unemployment Information Center, is a HUD approved housing counseling agency that handles hundreds of delinquency and default cases each year.

Under Mr. Dodds' leadership, PUP counts among its achievements campaigns that have led to, among other things, the Nation's first state foreclosure prevention program in Pennsylvania, the expansion of health care for the uninsured in the Commonwealth of Pennsylvania and city of Philadelphia, an innovative reverse commute project for inner city workers, increases in the state minimum wage, programs to protect income homeowners from real estate tax foreclosures and reductions in legal fees to families facing foreclosures.

Welcome to our panel, Mr. Dodds.

Our final witness is James Carr. Mr. Carr is the chief operating officer for the National Community Reinvestment Coalition, an association of 600 local development organizations across the Nation dedicated to improving the flow of capital to communities and promoting economic mobility.

Mr. Carr is a visiting professor at Columbia University in New York and George Washington University in Washington, D.C. Prior to his appointment at NCRC, Mr. Carr was senior vice president for financial innovation, planning and research for Fannie Mae Foundation and vice president for research at Fannie Mae.

He has also held posts as assistant director for tax policy with the U.S. Senate Budget Committee and as a research associate at the Center for Urban Policy Research at Rutgers University. Mr. Carr has appeared on numerous television stations, as a frequent radio talk show guest, and was a recipient of the 2003 Community Impact Award from the National Organization of Black County Officials.

Again, I want to thank you all for your willingness to participate in today's hearing. Without objection, your written statements will be placed into the record, and we would ask that you limit your oral testimony to 5 minutes.

You will note that we have a lighting system in front of you. When your time to speak begins, you will see the green light. Four minutes into your testimony, you will receive a yellow warning light that you have about a minute to summarize your testimony.

And alas, when the light turns red, your time has expired. If you are mid-thought when the red light comes on, we will allow you to finish your final thought before moving on to our next witness.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions, subject to the 5-minute limit.

With all the ground rules now established, I will invite Mr. Kemp to please proceed with his testimony.

TESTIMONY OF THE HONORABLE JACK KEMP, FORMER SECRETARY, UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Mr. KEMP. Thank you, Madam Chair. I am going to stay within 5 minutes of getting through my testimony.

Thank you for so kind an introduction. Congressman Conyers, thank you for your long-time friendship.

Oh, no wonder I couldn't hear myself.

Thank you, again, John, for your kind words. It has always been an honor to work with you.

And to my friend, Chris Cannon, good to see you.

And it is a particular pleasure to be next to a very dear friend, a great patriot, and a wonderful devotee of and advocate for civil rights and social justice in our country. Wade Henderson and I worked together arm in arm for the D.C. voting rights bill, and I want to tell him personally and publicly how much I appreciate his courage and tenacity on behalf of people who sometimes don't have a voice.

I think that is who I am speaking for today—people who don't have a voice in this great issue over stimulus. I really appreciate the Conyers-Chabot Emergency Home Ownership and Mortgage Equity Protection Act. I know it has been called the most dangerous thing that we could be doing right now. And I would find it dangerous if we don't do something like this.

I am not here as an expert on bankruptcy jurisprudence, but as a former Member of the House, HUD secretary, a long-time advocate for homeownership for all Americans as a real tool to strengthen our communities, our economy, while building wealth and assets for low and working families.

Madam Chair, I don't need to tell you about the role homeownership plays in our society. It embodies the American dream. It represents an invaluable economic asset for millions of families.

A strong housing market has been a principal engine for our Nation's economic growth, contributing the development of stable and thriving communities, broadening the tax base, and obviously allowing for rising employment opportunities.

Today's housing recession is, as you said and Chairman Conyers said, extremely serious. In perspective the overall economy is still growing, though slowing down. The subprime mortgage meltdown exists today because there was an abundance of liquidity and I believe fed by the Federal Reserve Board keeping interest rates too low for too long, and thus causing a housing bubble.

When Ben Bernanke came in, he took a 1 percent overnight cost of money, the Federal funds rate, to 5.25 in 16 straight steps, and all of a sudden those adjustable rate mortgages in the prime and

subprime area were absolutely causing balloon payments that have wiped out the value of people's homes.

At the end of last year, I was approached by a coalition of consumer advocacy and homeownership advocates and organizations, who asked that I consider supporting this bipartisan legislation as it was amended right here in this Committee.

As you know, having served as President Bush's HUD secretary and serving in Congress, I believed that bipartisanship alone is not the singular ingredient for good policy. However, in this case I salute the Chairman and Congressman Chabot and all the Members of the Committee who support this legislation for striking what I think is a right balance.

When I was the secretary of HUD, we fought against economic pessimism every day in an effort to spread the American dream of homeownership, particularly for moderate and low-income families. Homeownership, especially among people of color, has risen to historic levels, and they have got a long way to go.

In just the last 5 years, 2.5 million to 2.8 million families bought their very first home. Now, the subprime mortgage crisis is threatening to roll back this progress, and I can tell you flat out, if we can possibly do it, I want to keep people in their homes. That is the purpose of my testimony, and, I believe, this bill.

This bill will have more impact on these home owning families than any other option currently on the table, in my opinion. I see estimates that as many as 600,000 homeowners might be eligible, as well as preventing about $72 billion of wealth that would be lost to families who would be affected by virtue of their home being in a location near a foreclosed home.

Given the severity of this national crisis, allowing a judge to modify in bankruptcy court, I believe, is the right thing to do. The bill is targeted at only subprime and non-traditional ARM mortgages and would be available for only 7 years after it is enacted in order to mitigate against the next waves of rising interest rate resets.

I believe it is narrowly tailored and an appropriate remedy for homeowners and the right thing for the Congress to do. Now, some lenders' representatives—and I have got great respect for them, some here and some around this country; I worked with them in all 4 years of HUD—have claimed that H.R. 3609 would drive up interest rates and harm the securities market.

Now, there may be a legitimate reason why some of this country's biggest and largest banking institutions would oppose this legislation. But those reasons are not it. There is no data that support the contention that bankruptcy changes being contemplated in Congress would do either. H.R. 3609, as you well know, applies to existing loans only. Therefore, by definition it could not affect future interest rates, because it would not apply to future loans.

Now, there have been decades of experience in which bankruptcy courts have been modifying mortgage loans on family farms in Chapter 12, commercial real estate in Chapter 11, vacation homes, condo loans, investor properties in Chapter 13, with no ill effects—no ill effects on the credit in those submarkets.

Ms. SÁNCHEZ. Mr. Kemp?

Mr. KEMP. I am sorry.

Ms. SÁNCHEZ. Your time has expired. I will allow you to summarize your final thought.

Mr. KEMP. Let me summarize. As I wrote in a recent *Los Angeles Times* op-ed, bankruptcy law is widely off kilter in how it treats homeowners and homeownership. And I believe, Madam Chair, this is a legitimate, logical way to provide health and help for more than 600,000 homeowners.

Thank you very much for your hospitality.

[The prepared statement of Mr. Kemp follows:]

PREPARED STATEMENT OF THE HONORABLE JACK KEMP

Statement of the Honorable Jack Kemp
Former Secretary, U.S. Department of Housing and Urban Development

Before

The Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

United States House of Representatives

January 29, 2008

Chairwoman Sanchez, Ranking Member Cannon, Chairman Conyers and Members of the Committee, thank you for your invitation to discuss the subprime lending crisis facing America and legislation before the House that could help many of the 2.2 million Americans facing foreclosure save their homes. I particularly appreciate the opportunity to reemphasize the importance of the homeownership culture in America, which is why I am supporting the Conyers-Chabot "Emergency Home Ownership and Mortgage Equity Protection Act" as it was amended here in this Committee.

I am very pleased to be here today sitting next to my good friend Wade Henderson and all the other witnesses. It is a pleasure to work with him again as he is a committed advocate for Civil Rights, a real patriot, and I appreciate the invitation you have given us.

Mr. Chairman, I am here not as an expert on bankruptcy jurisprudence, but as a former Member of the House, HUD Secretary, and a long-time advocate for homeownership for all Americans as a tool to strengthen our communities and our economy while building wealth and assets for working families.

Mr. Chairman, I scarcely need to tell you about the role homeownership plays in this society. It embodies the American Dream and represents an invaluable economic asset for millions of families. A strong housing market has been a principal engine for our nation's economic growth, contributing to the development of stable and thriving communities, broadening the tax base, and rising employment opportunities.

Today's housing recession is serious, but in perspective the overall economy is still growing. The subprime mortgage meltdown exists because there was an abundance of liquidity, and soaring property values in many areas of the country, which allowed for exuberant lenders to provide ill-advised subprime loans, particularly unconventional ARM's representing 60% of foreclosures.

The impact of the subprime mortgage contraction is clear in certain areas; lending standards are tightening, subprime lenders are going out of business and the large investment banks are suffering significant losses after huge revenue increases resulting from the housing market. Most importantly, hard working Americans' homes are in jeopardy because the value of their home is less than their actual mortgage.

At the end of last year I was approached by a coalition of consumer advocacy organizations who asked that I consider supporting this bipartisan legislation as it was amended right here in this Committee. As you know, before I served as President Bush's HUD Secretary, I served as a Representative from Buffalo, New York in this Chamber. I know that bipartisanship alone is not the singular ingredient for good policy. However, in this case, I salute you Chairman Conyers, and you Congressman Chabot, and all of the Members of the Committee who supported this legislation, for striking the right balance through negotiation and producing a good bill. I am happy to support it.

When I was HUD Secretary, we fought against economic pessimism every day in the effort to spread the American dream of homeownership, particularly for moderate- and low-income families. Over the last 15 years, homeownership, especially among people of color, has risen to historic levels. In just the last five years, 2.8 million families bought their first homes. Now, the subprime mortgage crisis is threatening to roll back this progress. Experts predict that more than 2.2 million Americans are facing foreclosure as a result of this national crisis.

This bill will have more impact on these home-owning families than any other option currently on the table; I've seen estimates that as many as 600,000 homeowners might be eligible as well as preventing $72.5 billion of wealth being lost by families who are being affected by virtue of their location being near foreclosed homes. According to Mark Zandi, Chief Economist and Co-Founder of Moody's Economy.com, "allowing homeowners access to judicial modification would prevent about one-quarter of foreclosures likely to occur between now and the end of next year – or about 570,000 homes saved." In the absence of modification, many of today's loans will result in foreclosure. Given the severity of this national crisis, allowing judges to modify them in bankruptcy court is the right thing to do. The bill is targeted at only sub-prime and nontraditional mortgages and will be available for only seven years after it is enacted in order to mitigate against the next wave of exploding interest rate resets. I believe it is a narrow, tailored, and appropriate remedy for homeowners and the right thing for Congress to do.

Some lender representatives have claimed that HR 3609 would drive up interest rates and harm the securities market. There may be a legitimate reason why some of the country's biggest banking institutions would oppose this legislation, but those reasons are not it. There is no data that supports the contention that bankruptcy changes being contemplated in Congress would do either. HR 3609, as you well know, applies to existing loans only. Therefore, by definition, it could not affect future interest rates because it would not apply to future loans. While the bill has changed, the talking points against it have not.

In addition, the bill narrowly targets families who would otherwise lose their homes; not only must the borrower lack the income to pay their mortgage, after taking account of Spartan IRS expenditure allowances, but they must actually have received notice from their servicer that foreclosure is imminent. Since the only families who are eligible for relief are those who would have lost their home to foreclosure, the bill adds no new risk to mortgage holders. The loss will be caused not by the chapter 13 provision, but rather by the borrower's inability to repay the debt according to its terms; the alternative to judicial modification isn't full repayment, but nonpayment. Further, the bill guarantees lenders at least the value they would obtain through foreclosure, since a foreclosure sale can only recover the market value of the home, and saves lenders the high cost and significant delays of foreclosures.

There have been decades of experience in which bankruptcy courts have been modifying mortgage loans on family farms in chapter 12, commercial real estate in chapter 11, vacation homes and investor properties in chapter 13, with no ill effects on credit in those submarkets. Debt secured by all of these asset types, in addition to credit cards and car loans, are readily securitizable even though they can be modified in bankruptcy.

As I wrote in a recent LA Times op-ed, bankruptcy law is wildly off-kilter in how it treats homeownership. Under current law, courts can lower unreasonably high interest rates on secured loans, reschedule secured loan payments to make them more affordable and adjust the secured portion of loans down to the fair market value of the underlying property -- all secured loans, that is, except those secured by the debtor's home. This gaping loophole threatens the most vulnerable with the loss of their most valuable assets -- their homes -- and leaves untouched their largest liabilities -- their mortgages.

Examining mortgages during the first eight months of 2007, Moody's Investors Service found th lenders only modified 3.5% of subprime loans that reset to higher levels, compared with indust estimates that up to half of such borrowers facing reset will lose their homes to foreclosure.[1] addition, recent MBA data show that foreclosures are outstripping modifications 7 to 1; for tl

subprime ARMs that are the root of the current crisis, foreclosures outnumber modifications 13 to
Further, Secretary Paulson's plan for voluntary modifications is welcome, only 3% of subprin
ARM borrowers are likely to receive streamlined modification under its terms. Repayment plan
which require a subprime ARM borrower to pay the full 12% interest rate while catching up
delinquent payments at the same time, are ineffective. In the absence of detailed reporting, it is n
even clear that the few modifications that have occurred are sustainable. According to New Yo
Times reporter Gretchen Morgenson, "Countrywide has acknowledged that most of its modificatio
involved deferring overdue interest or adding the past due amount to a loan," not reducing intere
rates or principal balances on subprime ARMs."

I'd be remiss in not saying that there needs to be better scrutiny of lending practices and the rating agencies themselves. There is a consensus that the lack of effective oversight by the regulators of the primary and secondary mortgage markets contributed significantly to the problem we are now facing. Innovations in the mortgage industry can be good and useful. In fact, innovations by FHA, the secondary market and private sector lenders have been responsible for much of the unprecedented increase in the homeownership rate since World War II. At the same time, however, regulators can't be asleep at the switch and permit clearly unsound mortgage lending practices that place ordinary homebuyers at risk.

I applaud the White House and Treasury Secretary Paulson's continued efforts to encourage mortgage servicers to modify existing loans for a limited number of borrowers that cannot afford interest rate resets. However, depending solely upon the goodwill of an industry that bears no small measure of responsibility in this crisis is not the full answer.

I have been an advocate for free market principles and limited government for a long time so I know it's important for Congress to avoid an overreaction that would have negative long-term effects on the housing market. Allowing certain distressed homeowners limited bankruptcy protection provides the greatest potential benefit with the least market disruption, and it will not cost the Treasury a dime.

In closing, Mr. Chairman let me restate that the most pressing need is to help the more than 2.2 million families who are in danger of losing their homes. Of course, we need sound policies that prevent the kinds of abuses and disruptions we are now experiencing. But to help current homeowners we need measured and appropriate responses that have an immediate effect, to protect our citizens and encourage sound business practices.

As HUD Secretary, I saw firsthand that homeownership makes neighborhoods safer, encourages investment and raises our overall standard of living. People care more deeply about their neighborhoods if they have an ownership stake. Minorities, especially, need to be encouraged to own their homes in greater percentages if America is to truly democratize our free economic system. I hope the House will pass this legislation soon because I know how much America needs it. Thank you for the opportunity to testify here today and I look forward to your questions.

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i Christopher Cagan, cited in Ivry, Bob, "Subprime Borrowers to Lose Homes at Record Pace as Rates Rise" (Sept. 19, 2007), Bloomberg, available at: http://www.bloomberg.com/apps/news?pid=email_en&refer=finance&sid=akOEPee30TR4.

Ms. SÁNCHEZ. Thank you, Mr. Kemp. I appreciate your summarizing as quickly as possible. I know that you are not feeling well, so if you would like to leave the panel, you have the indulgence of the Chair to do so at this time.

TESTIMONY OF WADE HENDERSON, PRESIDENT AND CEO, LEADERSHIP CONFERENCE ON CIVIL RIGHTS, WASHINGTON, DC

Mr. HENDERSON. Chairwoman Sánchez, Ranking Member Cannon and Members of the Subcommittee, I am Wade Henderson, president of the Leadership Conference on Civil Rights. Thank you for inviting me to discuss solutions to the growing national epidemic of home foreclosures.

Before I begin my formal remarks, Madam Chair, I want to digress for a moment to thank you and, most importantly, Mr. Conyers, Mr. Chabot, Mr. Watt and leaders like Secretary Kemp for your extraordinary effort in last year's reauthorization of the Voting Rights Act.

The Voting Rights Act is one of the most important civil rights bills of our time, and the overwhelming support for its reauthorization is proof positive that the protection of civil rights is not a partisan issue. It is a national issue. And it is in that spirit that I come before you today.

Now, there is a great deal that can be said about what led to the Nation's foreclosure crisis, what impact it will have, and what could have been done to prevent it, and what our best options are now for moving forward. I am pleased to focus today on one of the best of those options.

At the outset I want to say that the Leadership Conference fully supports the version of H.R. 3609 that was approved by the full Committee, and I want to thank the sponsors for your leadership. H.R. 3609 offers a strong, yet pragmatic step that will save hundreds of thousands of families from losing their homes.

For the past several years, when I have testified or otherwise talked about the need for changes to our Nation's mortgage finance system, I have usually spent much of my time explaining what was going wrong and what the likely consequence would be for individual homeowners, the communities in which they live, and the economy at large. I obviously don't need to spend much time on that anymore. I think most Americans get it now.

Subprime lending, which can and should be used in a responsible way to create new homeownership opportunities for persons with impaired credit, was instead shamelessly perverted through recklessness, greed and unrealistic expectations. Dealing with it and with the havoc sweeping through the entire housing sector requires swift, multi-faceted and compassionate action.

We certainly want the industry, with the Administration's support, to do its share. But at the same time, individual homeowners and our economy as a whole cannot afford to wait for an industry that collectively created the mess, and is now being devoured by it, to take the lead in cleaning it up.

For several reasons we believe that using bankruptcy proceedings to avert foreclosures is one of the most important and timely steps Congress can take to deal with the foreclosure crisis.

One key advantage, especially as we face growing questions about the economy, is its cost. Because bankruptcy modifications do not involve public funds, H.R. 3609 will not give the appearance of a bailout or create moral hazard. And because bankruptcy comes at a heavy cost, monetary and otherwise, it does not let borrowers off the hook.

I should note parenthetically that many lenders have recently come to recognize the value of obtaining bankruptcy protection, which makes it ironic that borrowers cannot do the same.

At the same time, H.R. 3609 will benefit other homeowners and our economy. Every home that gets saved from foreclosure or from abandonment by borrowers expecting foreclosure, which is another growing problem, helps protect the value of neighboring homes, slowing a vicious cycle that leads to even more damage to affected communities.

Needless to say, empty houses are more than just eyesores. They also drain local government resources and undermine public safety. Now, while the bill will not save every home, it will greatly help control the bleeding, protecting communities from even more harm.

I would hope that every Member of Congress would recognize the value of that result, but I can't help but notice that it is now the Subcommittee's third hearing on this bill and that you have taken the unusual step of holding this one after the Committee's markup, which can only mean that there are still some very serious misunderstandings about H.R. 3609 that must be addressed.

The opposition to the bill is especially frustrating, because it generally comes from industry representatives, who, despite best efforts of civil rights and consumer groups, have long been reluctant to acknowledge the full extent of the problem we are facing.

As late as October, the industry told the Subcommittee, even after the problems with unsustainable loans had become painfully obvious to the public, that foreclosures are mostly the result of "unemployment, divorce or illness, and not the loans themselves."

Last year's rapid growth in foreclosure rates speaks for itself, and it is unsettling to wonder if the industry posturing might have delayed efforts to mitigate that growth.

Opponents of the bill also argue that the industry is working to reduce foreclosures through the use of loan modifications and repayment plans. But without a doubt, I am glad that many lenders and servicers recognize that there are serious problems and are taking steps to save homeowners from their mortgages.

I see the light has come on, so I will summarize.

Ms. SÁNCHEZ. I will allow you to finish your final thought.

Mr. HENDERSON. Thank you.

Let me say that this bill is such an important step, such a modest step, and such a fundamental protection for the rights of homeowners and the communities in which they live. We are happy to provide our full support for the enactment of this legislation.

Thank you, Madam Chair.

[The prepared statement of Mr. Henderson follows:]

PREPARED STATEMENT OF WADE HENDERSON

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STATEMENT OF
WADE HENDERSON, PRESIDENT & CEO,
LEADERSHIP CONFERENCE ON CIVIL RIGHTS

U.S. HOUSE COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

"THE GROWING MORTGAGE FORECLOSURE CRISIS: IDENTIFYING SOLUTIONS AND DISPELLING MYTHS"

JANUARY 29, 2008

Chairperson Sánchez, Ranking Member Cannon, and members of the Subcommittee: I am Wade Henderson, president and CEO of the Leadership Conference on Civil Rights (LCCR). Thank you for the opportunity to testify in today's hearing on identifying solutions to address the growing epidemic of home mortgage foreclosures our nation is currently facing.

LCCR is the nation's oldest, largest, and most diverse coalition of civil rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, the Leadership Conference seeks to further the goal of equality under law through legislative advocacy and public education. LCCR consists of approximately 200 national organizations representing persons of color, women, children, organized labor, people with disabilities, the elderly, gays and lesbians, and major religious groups. I am privileged to represent the civil and human rights community in submitting testimony for the record to the Committee.

There is a great deal that can be said about what led to this foreclosure crisis, what impact it will have, what could have been done to prevent it, and what our best options are now as our nation tries to face it. Today, I want to focus my remarks on one of the best of those options: H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007." At the outset, I should add that LCCR fully supports the compromise version of this bill that was adopted last December by the full Committee. It is a strong and thoughtful proposal that will save hundreds of thousands of families from losing their homes in the coming years.

"The Growing Mortgage Foreclosure Crisis" – A Quick Overview

For the past several years, when I have testified or otherwise discussed the need for changes in our nation's mortgage lending system, I have usually gone into a detailed explanation of precisely what was going wrong, and what the likely consequences for homeowners and the economy would be. At this stage, with an obvious crisis now upon us, I no longer think that a lengthy background discussion is necessary. So I will briefly summarize instead.

As this Subcommittee is all too aware by now, the mortgage lending industry engaged in the widespread use of utterly reckless and predatory lending practices during the nationwide housing market "boom" that took place in the first half of this decade. While the use of *responsible* subprime lending can create meaningful homeownership opportunities for people who might otherwise be excluded, many borrowers were deceptively steered into expensive subprime mortgages even though they qualified for prime loans.[1] In addition, many lenders took exotic practices such as "2/28s," "interest-only," "pay-option," "low-doc" or "no-doc" mortgages, prepayment penalties, and "yield spread premiums," and made them commonplace, abandoning sensible loan underwriting standards in the process.[2] Such practices guaranteed that massive numbers of borrowers would be unable to handle their monthly payments, and would soon face the prospect of losing their homes.

The consequences are still unfolding, but one thing is certain: they will be staggering. Home foreclosure rates are rapidly increasing throughout the nation and, according to an estimate by the Center for Responsible Lending, as many as 2.4 million borrowers – just in the subprime market alone – are likely to lose their homes.[3] The wave of foreclosures will have an especially harsh impact on racial and ethnic minority homeowners who, according to several studies, were roughly two to three times more likely to be steered into high-cost loans than white borrowers, with strong disparities persisting even after credit factors were taken into account.[4] As such, LCCR and its member organizations have a large stake in policies aimed at mitigating this crisis.

"Identifying Solutions" – The Merits of H.R. 3609

Turning more directly to the subject of today's hearing, I want to briefly explain why LCCR strongly supports H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007." I should add that we wholeheartedly endorse the version that was recently adopted

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[1] *See, e.g.* Rich Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy," *Wall Street Journal*, December 3, 2007 at A1.

[2] *See, e.g.* Comptroller of the Currency John C. Dugan, sharply criticizing widespread use of "no/low-doc" loans:

> Sound underwriting – and, for that matter, simple common sense – suggests that a mortgage lender would almost always want to verify the income of a riskier subprime borrower to make sure that he or she had the means to make the required monthly payments. But the norm appears to be just the opposite: nearly 50 percent of all subprime loans last year accepted stated income. . . . I do find it telling that, when faced with new housing market conditions, lenders have responded first by tightening standards on stated income. . . . Apparently verified income is viewed as a critical factor in determining whether a loan can be saved, which of course begs the question: if loan verification is such an important predictor of the borrower's ability to repay in the current environment, why wasn't it equally important when the loan was first made?

News Release: "Comptroller Dugan Expresses Concern Over 'Stated Income' Subprime Loans"; *Comptroller of the Currency*; May 23, 2007; available at http://www.occ.gov/ftp/release/2007-48.htm.

[3] Center for Responsible Lending, "Subprime Lending is a Net Drain on Homeownership," CRL Issue Paper No. 14 (available at http://www.responsiblelending.org/pdfs/Net-Drain-in-Home-Ownership.pdf), March 27, 2007.

[4] *See* Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, at 19 (available at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf), May 2006; National Community Reinvestment Coalition, *Income is No Shield Against Racial Differences in Lending: A Comparison of High-Cost Lending in America's Metropolitan Areas* (available at http://ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf), July 10, 2007.

by the full Committee, and I want to thank you, Chairman Conyers, and Representatives Chabot and Miller for working out such a sensible compromise.

H.R. 3609 will give hundreds of thousands of borrowers who are in danger of foreclosure a chance to save their homes through the use of Chapter 13 bankruptcy proceedings. Under its terms, bankruptcy courts will have several options for saving subprime and nontraditional mortgages that would otherwise end in foreclosure: they can 1) reduce the principal owed on a subprime or non-traditional mortgage to reflect the actual value of the home, 2) reset interest rates to affordable-but-fair levels, and 3) eliminate prepayment penalties and other abusive fees. Taking a pragmatic approach, H.R. 3609's provisions will only apply to loans made between Jan. 1, 2000 and the date of enactment, and it will sunset after seven years. While we certainly think it would be a good idea to make these changes permanent, the compromise is well-targeted for the current foreclosure crisis and its benefits will be substantial.

We believe, for several reasons, that using bankruptcy proceedings to avert foreclosures is one of the best policy responses available for the ongoing home mortgage meltdown. One key advantage – especially as we face an economic slowdown of unclear proportions – is its cost. Because loan modifications in bankruptcy court do not involve public funds, H.R. 3609 will not give the appearance of a "bailout" or raise moral hazard issues. Indeed, for people who want to go through bankruptcy court to save their homes, it will still come at a heavy enough cost – monetary and otherwise – to encourage wiser financial decisions in the future.

At the same time, H.R. 3609 will benefit other homeowners and our economy at large. Every home that gets saved from foreclosure – or from abandonment by borrowers who anticipate it because they cannot refinance or modify their loans[5] – helps to protect the value of surrounding homes from being eroded, meaning that other homeowners will be less likely to find themselves "upside down" on their own mortgages – a vicious cycle that, if left unchecked, can lead to even more foreclosures.

Needless to say, empty houses are more than just eyesores; they also drain local government resources and can even pose serious public safety hazards. While H.R. 3609 will not save every home, we do believe that it will greatly help to control the "bleeding," protecting neighborhoods and communities from even more financial harm than they might otherwise experience – and hopefully for long enough to allow housing markets to recover on their own.

"Dispelling Myths" – Opposition to H.R. 3609 Does Not Add Up

For the reasons I have set out above, LCCR greatly appreciates your efforts to enact H.R. 3609, and we will do what we can to help. At the same time, however, I cannot help but notice that this is now the subcommittee's third hearing on the bill – and that you have taken the even more unusual step of holding today's hearing *after* the measure was already cleared by the full

[5] There is anecdotal evidence that some borrowers are resorting to so-called "jingle mail," in which they abandon homes following unsuccessful efforts at refinancing, short sales, or loan modifications. *See, e.g.* Gretchen Morgenson, "Cruel Jokes, and No One is Laughing," *New York Times*, Jan. 18, 2008; Peter Y. Hong and Andrea Chang, "Pain goes through the roof," *Los Angeles Times*, Jan. 23, 2008.

Committee. Between that fact, and the title that you chose for today's hearing, it appears there are still some very serious misconceptions about H.R. 3609 that are interfering with its prospects.

I find the opposition to H.R. 3609 to be especially frustrating because it is has generally come from industry representatives who, for many years, and despite the best efforts of civil rights and consumer groups, have been reluctant to fully acknowledge the true nature of the problem we are facing. To give you one example, as late as October of last year, an industry witness insisted before your subcommittee – as the industry repeatedly did throughout last year, even after the problems with unsustainable lending practices became painfully obvious to the public at large – that foreclosures are mostly the result of "unemployment, divorce, and illness," or temporary financial setbacks, and *not* the result of loan products themselves.[6] The staggering recent growth in foreclosure rates throughout the country, particularly for subprime and nontraditional loans, strongly suggests otherwise – and it is unsettling to speculate whether such industry posturing might have delayed efforts to mitigate that growth.

Opponents of H.R. 3609 have also suggested that the bill is not needed because the industry is working to resolve the foreclosure crisis. In particular, they point to evidence that the industry is increasing the use of loan modifications and repayment plans.

Without a doubt, I am encouraged that many lenders and servicers in the industry now acknowledge that there are serious problems, and are taking steps to save homeowners from mortgages that were virtually destined to fail. I am also proud that many LCCR member organizations have been working diligently throughout the country, as intermediaries between lender and borrowers, in these efforts to reduce home foreclosures.[7]

According to data recently published by the Mortgage Bankers Association, 53,573 permanent loan modifications were reported in the third quarter of last year. Another 182,702 borrowers

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[6] In an October 2007 hearing before this Subcommittee, Mortgage Bankers Association Chairman-Elect David G. Kittle told Rep. Hank Johnson (D-GA) that "we keep talking about the mortgage products putting these people into foreclosure. . . . There are three main reasons for a foreclosure, Congressman, are unemployment, divorce, and illness not the mortgage products. So that need[s] to be said." Hearing, U.S. House Subcommittee on Commercial and Administrative Law: "Straightening Out The Mortgage Mess: How Can We Protect Home Ownership And Provide Relief to Consumers in Financial Distress?" *Federal News Service*; October 30, 2007.

This mirrors previous statements by the MBA, *e.g.*: "There is no evidence that product choices by borrowers are determinative of defaults or foreclosures. Different products have different default rates but the product choice does not cause the default." Statement of John M. Robbins, CMB, Chairman of Mortgage Bankers Association, before U.S. House Subcommittee on Financial Institutions and Consumer Credit, March 27, 2007, at 14.

Similarly, Countrywide Financial Corp. Chief Executive Angelo Mozilo claimed in May 2007 that "regulation, in my opinion, has caused part of the problem. When they attacked the pay option and interest-only loans, that really put a dent in a lot of the product, which is perfectly good product." "Countrywide Chief Decries Subprime Regulation," *Reuters*, May 21, 2007.

[7] The National Fair Housing Alliance, for example, in partnership with fair housing centers in New Orleans and Gulfport, has been providing direct assistance for nearly two years to hurricane-affected homeowners whose mortgages are in default. Even if Hurricane Katrina had not struck the area, most of the borrowers would be facing foreclosure because their loans were never affordable relative to their incomes. Its efforts have resulted in a number of successfully modified loans.

were placed into temporary repayment plans, which are usually meant – and usually only effective – for making up a few missed payments caused by a temporary financial setback.[8]

Again, any modification of a troubled mortgage loan is a positive development. Yet the MBA's data also shows that the number of foreclosures in the same period, 384,388, dwarfed modifications by a nearly seven-to-one margin.[9] Furthermore, without further information about the nature of the modifications granted to date, it is not clear whether they are actually sustainable in the long run. Countrywide, for example, had previously acknowledged during an investor call that most of its modifications merely "involved deferring overdue interest or adding the past due amount to a loan," not reducing interest rates or principal balances.[10]

Another voluntary effort to stave off foreclosures, the so-called "Paulson plan," is also a positive development – but is also insufficient to deal with the national foreclosure crisis. It will only reach a small number of subprime borrowers who are expecting significant interest rate resets, not anyone whose loan has already reset – and for the small number of borrowers who do qualify, it will only buy time.

In short, we applaud any and all voluntary industry efforts to stave off foreclosures. But until they are *proven* to be sufficient, they cannot in any way be a substitute for meaningful, broad-based legislative intervention. The stakes are simply too high.

Opponents of H.R. 3609 also argue that allowing bankruptcy courts to modify loans will make credit more expensive. The Mortgage Bankers Association, for example, predicts that mortgage rates would increase from 1.5 to 2 percent due to the prospect of bankruptcy cramdowns.

If true, this would certainly pose a legitimate concern. Yet it is not clear, either from previous congressional testimony or other materials on its "Stop the Bankruptcy Cram Down Resource Center" website,[11] how the MBA arrived at this figure. More importantly, because the Conyers-Chabot substitute version of H.R. 3609 only allows Chapter 13 cramdowns on already-existing mortgages, and only in cases where foreclosure is imminent (which would otherwise result in far more expensive losses due to the foreclosure process), it is difficult – at best – to comprehend how the substitute bill would lead to higher interest rates on loans in the future.

In an effort to more fully understand the basis for the industry's concern about higher interest rates, I examined the materials on the MBA's website. One recent letter to the House of Representatives, signed by 12 organizations opposed to the compromise version of H.R. 3609, quoted a Congressional Budget Office report – a report that found that the cost of the bill "*would* be higher interest rates" (emphasis added).[12] Hoping that the CBO report might shed more light

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[8] Mortgage Bankers Association, "An Examination of Mortgage Foreclosures, Modifications, Repayment Plans, and Other Loss Mitigation Activities in the Third Quarter of 2007," Jan. 2008, at 22.
[9] *Id.*
[10] Gretchen Morgenson, "Can These Mortgages be Saved?" New York Times, Sept. 30, 2007; *see also* Center for Responsible Lending, "Voluntary Industry Modifications Insufficient to Address Foreclosure Crisis Alone; Judicial Modification Needed," CRL Issue Brief, Jan. 28, 2008.
[11] http://www.mortgagebankers.org/stopthecramdown.
[12] American Bankers Association, *et al.*, letter: "Oppose H.R. 3609, the Emergency Home Ownership & Mortgage Equity Protection Act," (undated), at 1, available at

on the issue, I looked at the report – which, instead, said that the cost "*could* be higher interest rates, although the magnitude of the increase is difficult to predict and could depend on the exact change in policy" (emphasis added).[13] Sadly, instead of answering my question about H.R. 3609, the report only raised new questions about its most vocal opponents.

Like the industry opponents of H.R. 3609, I too am concerned about the need to preserve access to affordable credit for underserved populations. However, if the industry wants to avoid passing the risk of losses in bankruptcy proceedings on to borrowers, I have a few recommendations:

- It could carefully verify that borrowers have enough income to repay mortgages on a long-term basis;
- It could eliminate yield-spread premiums, which encourage brokers to steer borrowers into more expensive loans than their credit records would warrant;
- It could eliminate prepayment penalties, which make it harder for borrowers to refinance into loans that might save their homes;
- It could closely scrutinize appraisals before approving loans; and
- It could escrow additional expenses such as taxes and insurance.

In short, the industry could be far more careful in the future than it has been in the past. The use of responsible, sustainable subprime lending practices *can* expand home ownership, prove rewarding to investors, and avoid widespread foreclosures or any other losses. Before such lending can resume, however, it is essential that Congress do everything in its power to mitigate the current troubles plaguing the marketplace. This includes the enactment of H.R. 3609.

Thank you for both the opportunity to speak today and for your leadership as we move forward in addressing the foreclosure crisis. I look forward to answering any questions you may have.

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http://www.mortgagebankers.org/files/HouseJointLetterRegardingMortgageBankruptcy.pdf.

[13] Congressional Budget Office, "Options for Responding to Short-Term Economic Weakness," Jan. 2008, at http://www.cbo.gov/ftpdocs/89xx/doc8916/MainText.4.1.shtml.

Ms. SÁNCHEZ. Thank you, Mr. Henderson, for your testimony.

And I note that we have been joined by Mr. Chabot from Ohio, not a Member of the Subcommittee, but interested enough to come and sit in on today's proceeding.

So thank you for your attendance.

With that, I will invite Mr. Kittle to provide us with his testimony.

TESTIMONY OF DAVID G. KITTLE, CMB, CHAIRMAN-ELECT, MORTGAGE BANKERS ASSOCIATION, WASHINGTON, DC

Mr. KITTLE. Madam Chair, Ranking Member Cannon, thank you for the opportunity to appear before you again.

I am pleased to discuss the solutions to the situation in the mortgage market and to help dispel some myths relating to the Emergency Home Ownership and Mortgage Equity Protection Act.

It is a myth that allowing cramdowns of mortgages will be a cost-free and easy way to help homeowners. We expect that H.R. 3609 will cost your constituents hundreds of dollars a month and thousands of dollars a year. Passage of this bill will encourage homeowners to file for bankruptcy, an expensive and invasive process. Instead of encouraging homeowners to seek bankruptcy, Congress should focus on ways to keep people out of bankruptcy and in their homes.

There are very real and severe consequences for consumers who declare bankruptcy. Bankruptcy is a long, arduous and very public and expensive process, costing thousands of dollars in legal costs. Even when people file for bankruptcy, almost two-thirds of them are unable to fulfill the terms of their repayment plan.

Filing bankruptcy will allow a federally appointed trustee to scrutinize the consumer's every expenditure. Additionally, bankruptcy stays on a consumer's credit report for 10 years, making it difficult to acquire future credit, buy a home, car or insurance, and in some cases, even obtain employment.

If bankruptcy judges are allowed to independently change the terms of a signed mortgage contract, lenders will face new uncertainty as to the value of the collateral, the home. To account for the new risk, lenders will be forced to require higher down payments, higher cost at closing, and higher interest rates, pushing the dream of homeownership beyond the reach of millions of families.

As you know from my previous testimony, we estimate that a change in the bankruptcy law, allowing cramdowns in the future, may increase interest rates across the board by at least 1.5 percentage points for those seeking to buy a home or refinance their existing mortgage.

In Los Angeles County, California, for example, where the average home price is about $360,000, a homeowner's monthly payment at 6 percent for a 30-year fixed rate mortgage is roughly $2,100 per month. However, if H.R. 3609 were enacted, holding everything else constant, the homeowner could pay an additional $358 every month, an annual increase of over $4,200.

It is a myth that this legislation will actually be positive for the mortgage industry. Despite the changes made in the bill by Congressman Chabot, the legislation continues to be retroactive. The

result of a retroactive bill will be a devaluation of the current loan and mortgage servicing portfolio. This will have an immediate and severe impact on the mortgage market, as companies book the diminished value of their loans and servicing rights.

Rates will certainly have to rise to offset the anticipated losses. Some companies will not survive. The writedowns and the markets will go through another period of severe instability.

It is a myth that the total cost of foreclosure is greater than that of the risk of bankruptcy. Lenders often have mortgage insurance to protect themselves against losses. The FHA program is one kind of credit enhancement. Bankruptcy voids these credit enhancements in the amount of the cramdown. The lender will have to absorb the increased risk, which will ultimately pass on to the consumer in the form of higher prices or more restrictive lending terms.

It is a myth that the preference given to primary residences is simply a loophole. Congress acted deliberately to increase the flow of capital to homebuyers. The House acted with broad support when it passed the final version of the bankruptcy code in 1978. The Supreme Court supported this provision with a specific defense from Justice Stevens in 1993.

Finally, Congress should not encourage Americans to walk away from their debts. Bankruptcy is a final resort and should be sought only by the most extreme circumstances. At a time when the mortgage market is already experiencing a serious credit crunch, this bill threatens to increase costs to consumers, destabilize the mortgage market and result in injury to the overall economy.

We urge Congress to finish work on the stimulus bill, modernize the FHA and pass a predatory lending bill that provides uniform protection for all consumers. Congress should not change the bankruptcy laws and increase costs on every borrower seeking a new mortgage.

Thank you for the opportunity to appear before you again, and I look forward to answering your questions.

[The prepared statement of Mr. Kittle follows:]

PREPARED STATEMENT OF DAVID G. KITTLE

Statement of

David G. Kittle, CMB

Chairman-Elect, Mortgage Bankers Association

Before the

Subcommittee on Commercial and Administrative Law

Committee on Judiciary

United States House of Representatives

January 29, 2008

Hearing on

"Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths"

Madam Chairwoman, Ranking Member Cannon and members of the Committee, I am David G. Kittle, CMB, President and Chief Executive Officer of Principle Wholesale Lending, Inc. in Louisville, Kentucky and Chairman-Elect of the Mortgage Bankers Association (MBA).[1] I appreciate the opportunity to appear before you today to testify on behalf of MBA and the mortgage industry concerning the situation in today's market, to help identify solutions and to dispel the myths about legislation that would alter the treatment of home mortgages under Chapter 13 of the Bankruptcy Code.

The myths most in need of dispelling concern H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007," introduced by Representative Brad Miller and Chairwoman Linda Sanchez and amended by Representative Steve Chabot in the full Judiciary Committee. The amended bill makes key changes to Chapter 13 of the Bankruptcy Code including allowing the following changes for seven years:

- modification of "subprime" and "non-traditional" mortgages secured by principal residences ("home mortgages") originated between 2000 and the date of enactment of the bill;
- allowing home loans to be repaid beyond the term of the Chapter 13 plan, which today cannot exceed three to five years;
- eliminating the requirement to obtain credit counseling before the debtor can file for bankruptcy when the lender has notified the debtor that it may foreclose the loan; and
- requiring that fees and charges, accruing during the bankruptcy proceeding be filed with the court and that such fees do not exceed the value of the property.

If these provisions are enacted, there will be significant consequences for future borrowers, mortgage servicers, investors, pension funds and other global investors in mortgage-backed securities (MBS), as well as, the entire American economy. For these and other reasons, MBA opposes H.R. 3609.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Myth: H.R. 3609 Simply Closes a Loophole in the Bankruptcy Code
Fact: Congress Deliberately Acted to Improve Mortgage Market Liquidity

Today, a mortgage secured by the principal residence of a debtor cannot be modified in bankruptcy. This policy has been in existence over 100 years, since the Bankruptcy Act of 1898, and is a cornerstone to an efficient U.S. residential mortgage market. The protection provided to home mortgages was not a loophole or oversight. It was a deliberate act of Congress to ensure the continued low cost and free flow of home mortgage credit (see Legislative History, Attachment A). A shift in public policy to remove such protections will encourage debtors not to pay their contractual mortgage obligations and would dramatically change the residential mortgage market. H.R. 3609 would introduce significant risks for home lenders, investors and loan servicers. The risks include the ability to set aside certain mortgage contracts and modify interest rates and other terms. It would also allow liens to be stripped down to the fair market value of the underlying properties, although the bill does not define fair market value. The increased risk would result in mortgage lenders passing on the associated costs to borrowers in the form of higher interest rates and fees.

Myth: Passing H.R. 3609 (Chabot Compromise) Will Have Little Impact on Servicers and the Mortgage Market
Fact: H.R. 3609 Will Have Immediate and Long-Term Impact on the Mortgage Market

If H.R. 3609 were enacted, lenders, securitizers, investors, and loan servicers would see significant new risks on their existing portfolios. Because the bill, as amended by the Chabot Compromise, continues to be retroactive, these parties would absorb significant immediate losses that could have dire financial consequences. The obvious outcome of the bill would be that large principal losses never anticipated or priced into the interest rate or closing costs when the loan was made would have to be absorbed. Bondholders, including mutual funds, pension funds and government entities would see their investments decline. Servicers who never assumed principal risk of loss would suddenly have to absorb losses due to the loss of credit enhancements. Servicers and portfolio lenders with origination capability could offset the losses with new lending, however, such loans would have to carry higher interest rates and costs. Given the decline in originations, the costs would have to be concentrated on a smaller population and thus the cost of credit would be higher per borrower than if applied across a larger home buying or refinance population. The correlation of losses to income is not perfect and, as a result, new loan costs would be higher than necessary to cover real and anticipated losses and to ensure mortgage companies' continued solvency.

Moreover, bankruptcy attorneys would aggressively advertise to borrowers to seek the benefits of this bill if their homes have declined in value, whether or not

the borrower is in default. The cost of defending these bankruptcy cases would be staggering to the industry.

We believe that it is important for Congress to understand what H.R. 3609 actually does, to understand why it would so drastically affect the mortgage market and why MBA opposes its passage. In addition to the risks previously described, other risks are introduced, perhaps unintended, but which would have serious consequences. We would like to discuss the full range of risks in greater detail, which will illustrate why MBA is so concerned with this bill.

Myth: H.R. 3609 Would Not Have a Negative Effect on Mortgage Market Participants
Fact: Key Provisions of H.R. 3609 Would Introduce Substantial New Risks and Losses for Mortgage Market Participants

A. Permits Modifications and Strip Downs of Home Mortgages

As stated above, the bill amends section 1322(b)(2) of the Bankruptcy Code, which currently prohibits bankruptcy judges from modifying the terms of mortgages secured by "principal residences" in Chapter 13. The bill would permit bankruptcy courts to change the terms of certain mortgages without the lender's consent (often referred to as a "cram down"), including modifying the interest rate, extending the maturity date, capitalizing arrearages and reamortizing the loan. In addition, judges would be granted the authority to "strip down" a secured home mortgage. A strip down (sometimes also known as a "lien strip") is a type of cram down that effectively converts the portion of the secured debt that exceeds the fair market value of the home into unsecured debt. The unsecured portion is treated like other unsecured debt, which is generally paid little or nothing through the Chapter 13 Plan, and is discharged upon successful completion of the plan.

The modification provisions in H.R. 3609 apply to the vast majority of "subprime" and all "non-traditional" mortgages secured by principal residences." Unfortunately, the definition of "subprime" would also cover a significant number of prime loans. Needless to say, this broad application of cram downs to these mortgages would introduce substantial new risks not priced into the product or contemplated when originally setting servicing fees.

B. H.R. 3609 Eliminates Substantial Controls

In addition to permitting cram downs of home mortgages, H.R. 3609 goes further and would remove significant controls that virtually ensure that bankruptcy filings will skyrocket. Consumer groups perpetuate the myth the bill will *not* substantially increase creditor risk or mortgage costs because there are few cram downs of second homes and investor properties since cram downs were

permitted on those property types in 1978. Consumer groups fail to mention the whole truth.

H.R. 3609 would create a quintessential moral hazard. Today, the Bankruptcy Code generally allows mortgages other than those secured by principal residences of the debtor to be crammed down. However, if such loans are crammed down, the debtor must pay the *entire amount* of the secured claim within the three-to-five-year duration of the Chapter 13 plan.[2] The unsecured portion of the claim that gets crammed down gets an apportioned payment to the extent there is additional income or cash that can support those payments. If there are no funds remaining to pay unsecured creditors after paying secured and priority claims, the unsecured creditors receive nothing and the unsecured debt is discharged upon termination of the plan. For example, under current law, if a mortgage contract of $150,000 gets stripped down to $100,000, the debtor must pay the entire $100,000 within three-to-five years in equal monthly installments. This control limits unbridled runs on the bankruptcy court whenever property values or rates decline. This control, however, is stripped from the rights of creditors by allowing the modified home mortgages to be paid over 30 years. H.R. 3609 thereby would ensure more borrowers will seek Chapter 13 bankruptcy for home loans.

In addition to the restriction mentioned above, vacation homes and investment properties seldom get to the point of cram down because there is generally little reason to cram down these loans. A vacation home clearly is not necessary to provide a roof over the borrower's head and with no equity, and little or no income, is a burden on the estate. Likewise, an investor property that has no equity and a negative cash flow is not necessary for reorganization and is a burden on the estate.[3] Thus, cram down of these types of loans is seldom attempted. Instead, the lender obtains termination of the automatic stay and the property is foreclosed without stripping down the lien. Conversely, a principal residence *is essential* to the reorganization of the borrower and thus if H.R. 3609 were enacted, courts would not release the assets from the stay and judges would be required to impose strip down of the lien. In effect, H.R. 3609 would treat home mortgage debt far worse than other secured debts in bankruptcy.

By stripping down secured debt, H.R. 3609 also would make more funds available in the repayment plan for credit cards and other unsecured debts. This is contrary to the basic legal premise of secured debt. Bankruptcy is generally a zero sum proposition. If funds are deducted from one set of debts – the priority debts, such as a home mortgage – it makes more funds available for non-priority and unsecured debts. While it may not be this Committee's intent to shift the bankruptcy process to the advantage of credit card and other unsecured lenders, this would be one of the impacts.

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[2] 11 USC 1322(d)(2007). See also In re Enewally, 368 F.3d 1165 (9th Cir., 2004).
[3] Investment properties with no equity but with a positive cash flow are still subject to repayment during the 3/5 year term of the plan and thus seldom get crammed down.

Because H.R. 3609 also removes the credit counseling requirement when the debtor has received notice of possible foreclosure, the bill would remove the final control against unfettered bankruptcy filings. Congress enacted the pre-filing counseling requirement to assure that debtors in financial difficulty had the benefit of two independent sources of information – approved non-profit counselors and bankruptcy attorneys. Credit counselors are well-versed in housing assistance to help a borrower save his home without filing bankruptcy.

There is no doubt the impact of the modification provision combined with elimination of all creditor protections would result in increased Chapter 13 filings. The considerable incentive of financial gain to the borrower would ensure cram downs on home loans would skyrocket. Servicers, portfolio lenders and bondholders would suffer significant losses. New creditworthy borrowers would have to pay for the value of these "takings." Financially responsible borrowers in the future would pay for the risky behavior and speculative decisions made by existing borrowers. Lenders would have a fiduciary duty to offset losses created by this bill through higher interest rates, points and fees on new loans. Anticipated losses from cram downs could trigger additional lay-offs in the mortgage industry, including lay-offs at mortgage servicers. The legislation would result in a further constriction of mortgage credit. These would not be welcome developments as most companies have tripled or quadrupled staffing to process loss mitigation requests and handle delinquent loans.

C. Cram Downs Voids Significant Types of Credit Enhancements

Proponents of bankruptcy reform argue creditors will take the same losses if the loan is stripped down to the fair market value as they would if the loan is foreclosed. This is a myth, as it fails to recognize certain insurance contracts would be voided for the amount of the cram down.

Specifically, servicers lose their FHA insurance and VA guarantee claims for the amount of any lien strip down. The servicer would have to advance the amount stripped down to Ginnie Mae security holders and absorb the principal loss. This is a substantial shift in liability that servicers certainly did not contemplate when they agreed to service Ginnie Mae securities. As stated previously, servicers rarely take principal losses today. The severity of losses to which servicers would now be exposed would be comparable to what FHA and VA lose with each foreclosure – more than $30,000 per property. Yet, if those loans went to foreclosure sale, FHA insurance and VA guarantees would protect the servicer against principal loss.

VA and FHA loans are not insulated from the havoc H.R. 3609 would wreak. In fact, the Chabot Compromise's definition of subprime as a loan with a three point spread over Treasury securities of comparable maturity measured at the time of

application ensures a significant number of government loans (and prime loans) would be eligible for lien stripping.

The risk of uninsured losses and repurchase risk created by H.R. 3609 would cause existing servicing portfolios to decline in value, requiring accounting write downs of servicing assets. The velocity at which loans would enter bankruptcy could cause capital and liquidity problems for servicers. This disruption could also cause significant problems with voluntary mortgage workouts as bankruptcy cram downs would consume the servicer's financial and personnel resources. The stated objective of encouraging more voluntary workouts through H.R. 3609 would simply not materialize because (1) the reward in bankruptcy is far more lucrative than what servicers could offer and (2) servicers may have to cut costs to offset losses by eliminating critical jobs.

When these government programs were created, there was no risk of cram down on home mortgages. As a result, authorizing statutes and regulations of the government programs fail to deal appropriately with the risk that would be created by H.R. 3609. Statutes were developed to deal with foreclosures, not bankruptcy modifications and strip downs. FHA and VA are not permitted *by statute* to pay an insurance claim or guarantee for the strip down amount. [4] It was simply not contemplated. An additional act of Congress would be required to restore these credit enhancements.

At a time when the public policy process is moving toward an increased reliance on the FHA and VA to serve the low income and first time homebuyers, H.R. 3609 would disadvantage government lending and drive lenders away from it.

D. Impact of Cram Downs on Investors and the MBS Market

Securitization increases homeownership. Today, banks and other lenders resell mortgage debt to other investors, or "securitize" it. This frees up capital and allows banks and mortgage companies to invest more into local economies and makes home mortgage credit more widely available. As a result, homeownership has risen significantly since the mid-1990s. The share of Americans who owned homes rose from 64 percent in 1994 to 69 percent by 2005. This is the highest increase in homeownership since the surge that followed World War II.

Securitization of mortgages is based on the underlying value of those mortgage contracts. Granting bankruptcy judges the authority to retroactively modify a mortgage in Chapter 13 proceedings would have a materially adverse impact on the mortgage contract. The resulting uncertainty would mean securitizers or

[4] 12 USC 1710a (2007). FHA can only pay a claim when it receives title to the property, the mortgage is foreclosed, the loan gets assigned, there is a pre-foreclosure sale or there is a loss mitigation partial claim. A partial claim is a specialized loss mitigation tool, which allows arrearages to be subordinated into a junior lien held by HUD. VA is only allowed to pay the unpaid principal balance, plus accrued interest and applicable charges. 38 USC 3832 (2007).

investors could not assess prices or calculate the risk of how many mortgages could be modified. If, with a stroke of a pen, the US government could eliminate the entire secured nature of these investments whenever there is a cyclical down turn in the real estate market, why would investors return the our mortgage markets? They would simply take their money to other more secure and predictable investments. Existing MBS values would also decline as investors dump MBS collateralized by subprime and at-risk assets and as credit rating agencies further downgrade securities.

Investors such as Fannie Mae and Freddie Mac also would be required to purchase the covered loans out of the MBS pools if the loans are modified and absorb the principal losses.

E. Lenders Will be Forced to Absorb the Risk of Properties Damaged by Natural Disasters or Borrower Misconduct

Another significant concern created by H.R. 3609 would be the windfall borrowers would obtain when the property is either 1) damaged by the borrower or 2) damaged by natural disasters such as Hurricanes Katrina and Rita or the recent wildfires of southern California.

Borrowers in default often fail to properly maintain their property, and sometimes intentionally damage their property. In some cases, borrowers attempt significant renovations but fail to complete them, leaving the collateral significantly devalued. We do not believe these debtors should be rewarded through loan stripping, but H.R. 3609 would do just that if passed.

Likewise, we do not think borrowers should be able to wipe out the security interests of creditors when their properties are destroyed by natural disasters, but H.R. 3609 could do just that. A recent relevant example is the damage to properties from Hurricanes Katrina and Rita. As you may know, lenders have offered borrowers who were impacted by the hurricanes over two years of forbearance and/or have also modified their mortgages. Some properties have zero or negative values. Now that insurance and Community Development Block Grant (CDBG) money is flowing to homeowners to rebuild these properties, this legislation would render a devastating blow to investors and servicers: the ability for borrowers to wipe out *all or significant portions* of the debt in Chapter 13 bankruptcy.

The impact of lien stripping on insurance proceeds and grant funds as secured assets is also brought into question. Based on cases associated with other secured debts, it appears creditors may lose their secured interests in hazard insurance proceeds for the amount of the cram down, with possibly no recourse to recover the value of the original debt. H.R. 3609 would place lenders, servicers and investors in an inappropriate role of property insurers of last resort

and/or guarantors of property values. Lenders and servicers would not have priced for the risk at origination, and would require cross-subsidization from new originations to avoid massive losses. That cross-subsidization would result in higher costs for new loans.

Myth: Consumers' Only Benefit Will Be Foreclosure Avoidance
Fact: H.R. 3609 Gives Enormous Windfalls to Borrowers

What is probably one of the most inequitable results of H.R. 3609 is the fact that debtors in depressed real estate markets or with damaged or destroyed properties would reap a windfall at the expense of borrowers who honor their debts, as well as servicers and investors. This windfall would occur if the borrower is permitted to reduce the debt to the depressed value of the property, retain the property and realize future appreciation in value when market conditions improve (or repairs get made with insurance and government aid), while having no obligation to pay the lender the full contractually agreed upon debt. Executing a strip down based on a snapshot of value ensures borrowers will make significant profits when the property appreciates later in time. The case in point is illustrated by In re: Enewally 368 F.3d 1165 (9th Cir., 2004).[5] Despite the current market turndown, over the last 30 years home prices nationally have risen six percent per year on average.[6]

The unfair result H.R. 3609 would create does not occur today in Chapter 7 or when the borrower is allowed to foreclose on the property. The creditor in either case would have the right to acquire the property by bidding its claim. The creditor could then, if it chose, hold the property until market conditions improved (and retain full mortgage insurance benefits and security interests in hazard insurance and grant proceeds in the case of damaged property), thereby reducing its losses. Furthermore, with foreclosures, the servicer could in most cases seek a deficiency judgment for the difference between the value of the property and the contractual obligation. No such remedies are permitted in H.R. 3609.

Myth: H.R. 3609 Is Needed Because the Mortgage Industry Is Not Doing Enough to Help Borrowers in Need
Fact: Industry is Engaged in Historic Efforts to Assist Distressed Borrowers

Recently, MBA released an empirical report on how servicers helped borrowers in the third quarter of 2007. As indicated earlier, this was before the HOPE NOW initiative got off the ground, so it gives a good sense of servicers' traditional

[5] At the time of the bankruptcy court's ruling in 2001, the debtor's property had declined in value to $210,000. The mortgage debt was approximately $245,000 and the borrowers sought cram down. However by the time the United States Supreme Court rejected the Writ of Certiorari three years later, that same property was worth $600,000. Had the debtors' cram down not been overturned on appeal, the debtors would have received a significant windfall.
[6] OFHEO House Price Index.

ability to help, while also setting a floor from which the industry could be judged moving forward. The report is included in the testimony, but several important facts should be highlighted.

During the third quarter of last year, mortgage servicers helped about 183,000 borrowers through repayment plans. They modified the rates or terms on about 54,000 more loans, 3,000 of which were subprime ARM loans, 15,000 subprime fixed rate loans, 4,000 prime ARM loans and 21,000 prime fixed-rate loans. As you can see from these numbers, the industry helped over 230,000 borrowers.

The MBA paper also discussed something known in our industry as the "Moody's One Percent Number." In September 2007, Moody's released a study suggesting the mortgage industry had assisted only one percent of the people who needed help. A later report then increased the number to 3.5 percent. Unfortunately, these numbers were not put into the proper context and represent a poor picture of how many people have been helped. In fact, the Moody's report that indicated loan modifications had increased to 3.5 percent, clearly noted the actual percentage of borrowers who received some type of ***workout*** was 24 percent.

The problem with this type of analysis is the math was off in two places. In order to come up with a percentage, a researcher uses simple high school level division, with a numerator and a denominator. The Moody's report limits the numerator to loan modifications and excludes all other types of assistance offered to borrowers. As discussed earlier, borrower assistance can come in many different forms. This is not the kind of process that produces a single solution for every consumer. The denominator Moody's used was the complete universe of subprime ARMs whose rates reset in a particular period. In the third quarter of 2007, according to MBA's National Delinquency Survey, over 80% of subprime ARM borrowers were paying on time. Certainly Moody's was not advocating that mortgage servicers modify the loans of people who are paying on time and who had not contacted the servicer for assistance?

A more appropriate measure is to look at the number of people helped relative to the number who become seriously delinquent or request help. It makes no sense to compare the smallest possible number of people who get help (those who receive formal loan modifications) against the largest possible number of borrowers (the total number of resetting subprime ARMs).

Members of this Committee have discussed their goal of keeping people in their homes. The Mortgage Bankers Association absolutely shares that goal. No one wants a family to lose its home and MBA's members are trying their best to help. Servicers are providing unprecedented levels of loss mitigation to eligible borrowers in distress. These alternatives to foreclosure include forbearance and repayment plans, modifications, partial claims, short sales and deed in lieu of foreclosure.

The single largest barrier to helping consumers is the low contact rate servicers have with borrowers. Historically, 50 percent of borrowers who reached foreclosure had no contact with the servicer despite multiple efforts on the servicer's part to reach out. Contact volume is still low and borrowers often simply don't know where to turn for reliable advice and assistance. Servicers have been working diligently to ensure all borrowers know about alternatives to foreclosure and to coordinate with housing counselors if borrowers are uncomfortable talking to their servicers. To help provide a coordinated and centralized approach to foreclosure prevention, the industry, with the assistance of the Department of Treasury and Department of Housing and Urban Development launched HOPE NOW.[7] While Faith Schwartz, Executive Director of HOPE NOW, will provide greater detail on the accomplishments of the industry, it is important to highlight HOPE NOW servicers have mailed approximately 500,000 letters to no-contact delinquent borrowers alerting them of the servicer's loss mitigation telephone number and the toll free HOPE Hotline. In addition, HOPE NOW servicers are centralizing their points of contact for expedited service to counselors and are providing counselors with new technology to expedite loss mitigation solutions.

Myth: Bankruptcy is the Preferable Way to Help Consumers
Fact: Bankruptcy is a Long, Difficult and Burdensome Process with Severe Long-Term Negative Consequences for Consumers

The proponents of bankruptcy reform fail to acknowledge the very real and severe consequences for consumers who declare bankruptcy. A bankruptcy stays on a consumers' credit report for 10 years, making it difficult to acquire future credit, especially in the tighter credit environment. Bankruptcy makes it more difficult for borrowers to get credit cards, buy a home, car or hazard insurance and in some cases, obtain employment. Bankruptcy costs consumers about $3,000 in attorney and court fees. Two-thirds of bankruptcy repayment plans fail. Moreover, bankruptcy repayment plans do not take into account new expenses that an individual incurs, such as unanticipated health related costs or emergencies. Attached to the testimony is a document produced by Professor Lynn M. LoPucki detailing the bankruptcy process (also available at http://www.bankruptcyvisuals.com/viewcharts.html). It is inconceivable Congress would rather push people into this process rather than focus on other more effective and less burdensome ways to help consumers.

Myth: H.R. 3609 Will Put Second Lien Holders in No Worse Position Than They Are Today
Fact: The Second Lien Market Will Be Badly Hurt from this Legislation

The second mortgage market has been particularly hard hit by current declining real estate values. Many borrowers are not paying their second mortgages when the fair market value of their property declines below the principal balance of the

[7] http://www.hopenow.com/

second loan. The second lien holder is left with no other option, but to allow the delinquency to continue, but retain the lien. They are not foreclosing on the second mortgages. These delinquent borrowers are not necessarily insolvent. Eventually home values will rise and these borrowers will begin repaying their second liens. H.R. 3609 would take away the lender's right to retain the lien and seek repayment at a later date. H.R. 3609 would wipe out existing second lien holders that are deemed subprime.

These second liens serve as credit enhancements for many first mortgages in the subprime market and thus are not and should not be extinguished indiscriminately. Proponents claim lenders are no worse off in bankruptcy than in foreclosure. This is a myth. This facile analysis fails to recognize many lenders, especially second lien lenders, are not seeking foreclosure, and are thus preserving their assets. H.R. 3609 would strip lien holders of this crucial right, effectively taking the asset from them.

Myth: Congress Has Not Done Enough to Address the Subprime Crisis
Fact: Congress Can Take Great Pride in Its Response to the Crisis

Members of the House can take considerable pride in the steps taken to address problems in the mortgage market. The House passed legislation modernizing the Federal Housing Administration (FHA), giving it a greater ability to help troubled borrowers refinance their loans. The House passed legislation that would exclude discharged debt on principal residences from gross income for tax purposes, thereby saving borrowers already in trouble from higher tax bills and encouraging work outs. The House passed meaningful housing government sponsored enterprise (GSE) reform and passed legislation establishing an affordable housing trust fund to ensure more high quality housing is available for more low- and moderate-income families.

Moreover, the House passed H.R. 3915 that would create a new legal regime for the mortgage market. This is a very serious piece of legislation. The mortgage industry believes it should be significantly improved. As this activity shows, the answer to this problem lies in improving the statutes governing lending, not in amending the bankruptcy code.

In addition to Congressional actions, FHA recently announced FHASecure,[8] which allows borrowers the opportunity to refinance into FHA insured loans. What is remarkable about this program is that it would allow a borrower who is six months delinquent on an ARM to refinance into an FHA loan, despite his or her delinquency, provided the borrower had a good payment history prior to the ARM rate reset and can afford the new payments. The program also allows borrowers who are upside down on their mortgages (i.e., owe more than their property is worth) to refinance a portion of their loan into non-FHA insured subordinate liens. In the past, combined loan-to-value requirements prohibited

[8] http://www.fha.gov/about/fhasfact.cfm

such activity. Unfortunately, it is unclear whether the threat of H.R. 3609 would discourage these subordinate loans from being originated, thus depriving borrowers of useful assistance.

While Congress has made strides in assisting borrowers in distress, H.R. 3609 would go too far. It encourages damaging behavior that would only serve to increase the cost of credit to financially responsible borrowers in the future and would place at risk the solvency of mortgage servicers and lenders, while also reducing the value and yield on certain securities. It would repudiate existing contracts, void credit enhancements, rights to certain insurance claims, trigger mandatory buyback options and impose a home price guaranty on existing mortgages. For proponents to argue these changes would not have a significant affect on lenders, servicers and bondholders is either dangerously naïve or simply disingenuous.

Conclusion

MBA opposes H.R. 3609 because of the harm it would cause to the mortgage market and borrowers who seek home mortgages. While well-intentioned, H.R. 3609 would increase rates significantly, dry up investor interest in mortgage-backed securities and impose significant losses on the mortgage industry and bondholders. Credit enhancements that protect lenders and investors from loss in the event of foreclosure would be void for the amount of the lien strip. Noteholders' interest in insurance claims would be at risk. With investor appetite for U.S. mortgages waning, it is ill-advised to pass legislation that would further disrupt the mortgage market. We urge Members of the House to look deeper into the implications of H.R. 3609. We are convinced that upon further detailed analysis you will agree that further action on this legislation is ill-advised.

Thank you for this opportunity to share our concerns with the Subcommittee.

Legislative History on the Enactment of the Bankruptcy Code And the Anti-Modification Provisions For Mortgages Secured by Principal Residences

MBA was asked to provide information on the legislative history associated with the current status of the Bankruptcy Code that prohibits modification of a mortgage secured by the borrower's principal residence, but permits such modifications on other mortgage debt, including mortgages on second homes and investor properties.

Consumer groups argue that the prohibition against modifications and cram downs for home mortgages was first offered in 1978 with the passage of the Bankruptcy Code. This is not accurate. The protection against cram downs and modifications of mortgages secured by principal residences has been in existence since the 1898 Bankruptcy Act. In fact, under the Bankruptcy Act, an individual wage earner's plan could not modify or otherwise affect the rights of a holder of a mortgage on the real property of the wage earner.

When the Bankruptcy Code was first proposed to replace the Bankruptcy Act, in the House, no limitations were set on the ability of an individual wage earner to modify the rights of holders of secured claims or of holders of unsecured claims.[1] The Senate version, on the other hand preserved the expansive protections afforded real estate mortgage creditors in Chapter XIII of the Act.[2] The report accompanying the bill noted that the Senate bill would not permit modification of "claims wholly secured by real estate mortgages."[3]

At the Senate hearing in the 95th Congress on November 29, 1977, MBA and other representatives of mortgage industry voiced concerns that the House version of Section 1322(b)(2) would limit the availability of mortgage funds. In testimony before the Subcommittee on Improvements in the Judicial Machinery of the Committee on the Judiciary, Mr. Edward J. Kulik, Senior Vice President, Real Estate Division, Massachusetts Mutual Life Insurance Co., pointed out that reducing a mortgagee's claim to the actual value of any real estate securing the claim would have a dramatically negative impact on the mortgage industry.

Specifically addressing the proposed provision of Chapter 13, Mr. Kulik emphasized that the House version of Section 1322(b)(2) would have a particularly adverse impact on the availability of home mortgage funds, especially where the financial resources of the individual home buyer were not particularly strong. To avoid this result, he proposed that the legislation be modified to protect holders of residential mortgages. He stated:

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[1] H.R. 82000, 95th Cong., 1st Sess. (1977).
[2] S. 2226, 95th Cong. 2d Sess. (1978)
[3] S. Rep. No. 989, 95th Cong. 2d Sess., 141 (1978).

> "Serious consideration should be given to modifying [the legislation] so that at the leas[t] ..., a mortgage on real property other than an investment property may not be modified.[4]

It is against this background that the compromise language embodied in present Section 1322(b)(2) of the Bankruptcy Code was adopted. The language preserves the protections afforded mortgage lenders under Chapter XIII of the Bankruptcy Act then in effect, but restricts that protection (along the lines that Mr. Kulik suggested) to mortgages secured by residential property of the debtor. The intent of this provision is explained in the Joint Explanatory Statement agreed on by the House and the Senate floor managers, following the floor debates on the compromise bill:

> "Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor's principal residence."[5]

Several courts since passage of the Bankruptcy Code have also viewed the anti-modification protections to be as a result of "a congressional reaction to fears that, if debtors were allowed to readjust all types of secured debt, including home mortgage loans, this would severely affect the stability of the home mortgage finance industry and the availability of financing by the industry by consumers."[6]

In *Grubbs v Houston First American Savings Assn*, the Fifth Circuit explained the reason for this exception:

> "This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings . . . that home-mortgage lenders performing a valuable social service through their loans needed special protection against modification thereof (i.e., reducing installment payments, secured valuations, etc.)"[7]

Of considerable importance in understanding the legislative history of the treatment of home mortgages in Chapter 13, is the recognition that the enactment of Section 1322(b)(2) occurred following very serious consideration by policymakers. In a series of Acts over almost six decades, Congress developed programs, institutions, favorable tax treatment and broad legislative intent to encourage homeownership and efficient financing for homeownership for Americans of modest means. The FHA mortgage insurance programs, the VA

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[4] Bankruptcy Reform Act of 1978, Hearings before the Subcommittee on Improvements of the Judicial Machinery Committee on the Judiciary, 95th Cong., 1st Sess. 709, 714 (1977).
[5] 124 Cong. Rec. S17424 (October 6, 1978)
[6] Victoria Miles, , *The Bifurcation of Undersecured Residential Mortgages Under §1322(b)(2) of the Bankruptcy Code: The Final Resolution,* 67 Am. Bankr. L.J. 207 (Spring, 1993)
[7] Grubbs v. Houston First American Savings Assn, 730 F. 2d 236, 246 (CA5 1984)

Home Loan Guaranty Program, Fannie Mae, Freddie Mac, Ginnie Mae and the ability to deduct interest payable on home mortgage are each examples of the Congressional intent to foster a robust mortgage credit market and to encourage homeownership.

Procedure Under Chapter 13 of the Bankruptcy Code

Updated to BAPCPA of 2005

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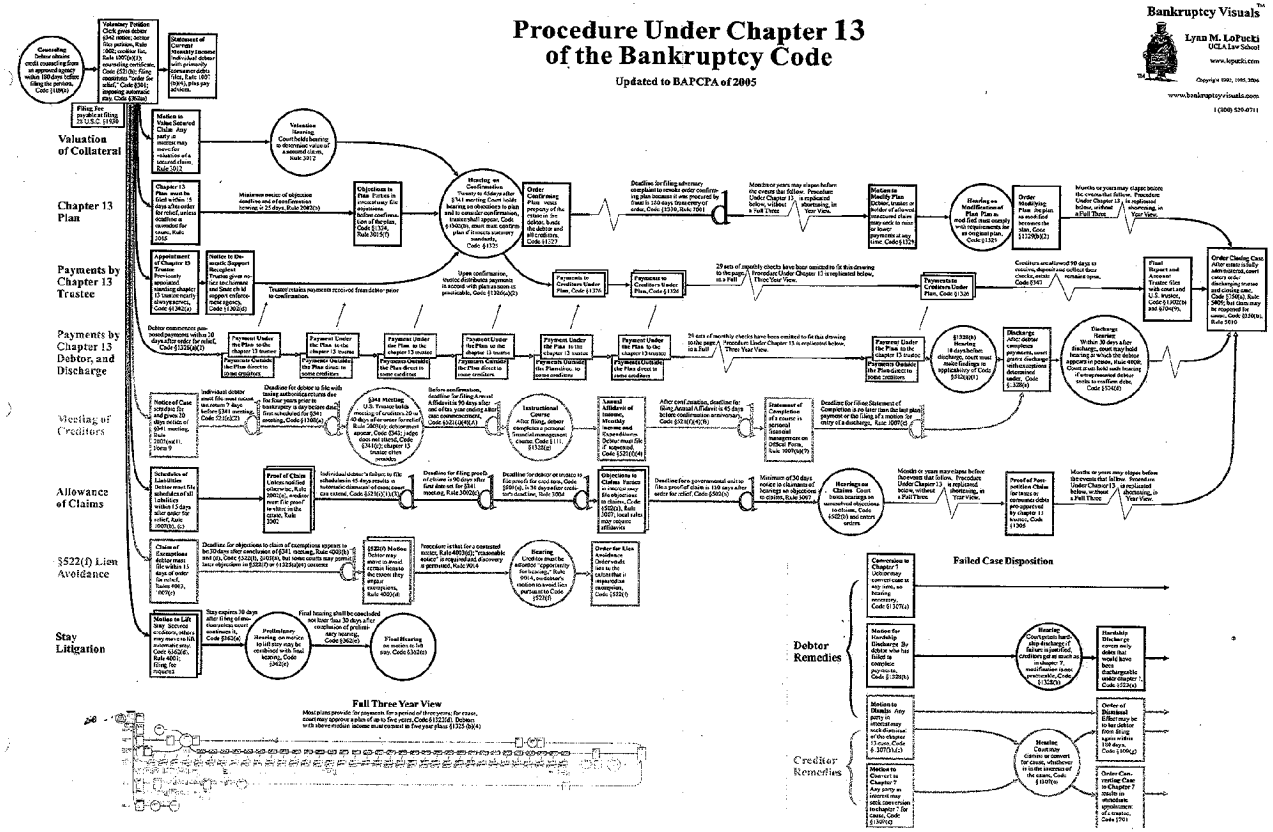

AN EXAMINATION OF MORTGAGE FORECLOSURES, MODIFICATIONS, REPAYMENT PLANS AND OTHER LOSS MITIGATION ACTIVITIES IN THE THIRD QUARTER OF 2007

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The rate of mortgage foreclosures started in the United States set another in a series of record highs in the Third Quarter of 2007. The increases for prime adjustable rate mortgages (ARMs) and subprime ARMS were particularly alarming. The *increase* for prime ARMs between the second and third quarters was larger than the *level* of foreclosure starts just a year earlier. Similarly, the increase for subprime ARMs was only slightly below the level of foreclosure starts only a few years ago. While fixed rate prime and subprime loans also had increases in their rates of foreclosure started, the increases were not of the same magnitude as those seen for ARMs. While ARMs historically perform worse than fixed-rate loans, even when interest rates are falling,[1] the magnitude of the rapid increase of foreclosure rates in the third quarter for ARMs relative to fixed-rate loans points to the role being played by rate resets. This has led to calls by various regulators, elected officials and industry observers for a freeze on ARM payments until the current situation with mortgage defaults, home price declines and high level of unsold home inventories begin to subside.

This paper is a snapshot of the actions lenders took to assist borrowers in the third quarter of 2007, including loan modifications, repayment plans, deed in lieu transactions and short sales. More importantly, however, it examines the extent of these other circumstances so as to put the degree of assistance to borrowers into some sort of context. It looks at the number of foreclosures attributable to borrowers who do not occupy the properties, borrowers who cannot be located or won't respond to lenders and borrowers who have already failed a previous repayment plan. It finds that, during the third quarter the approximately 54 thousand loan modifications done and 183 thousand repayment plans put into place exceeded the number of foreclosures started, excluding those cases where the borrower was an investor/speculator, where the borrower could not be located or would not respond to mortgage servicers, and when the borrower failed to perform under a plan or modification already in place.

1 Among the possible reasons are that borrowers are attracted to the loan with the lowest initial payments and do not sufficiently plan for higher payments, and that the choice of an ARM is correlated with risk-taking behavior or other credit risks that are not revealed in normal credit evaluations.

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Introduction

Two types of loans have received broad discussion as their rates reset, subprime "2/28" and "3/27" loans. While the features of these loans varied from lender to lender, a typical "2/28" loan gave the borrower a low introductory teaser rate for a few months,[2] when the rate would rise to a fixed rate for the balance of the two-year period. At the end of the two-year period the rate would increase to a fixed spread over a short-term rate index like LIBOR, usually resulting in a large increase in the required monthly payment. In addition, some of these loans were interest-only during the initial two year period, meaning that at the end of the two-year period the monthly payment increased not only due to the increase in the interest rate but because loan principal payments kicked in also.

Traditionally, typical borrower outcomes ranged from refinancing into a prime loan, refinancing into another subprime loan, making the higher payments or selling or losing the house. If the borrower had made most, if not all, of the payments on time during the two year period, the borrower could refinance into a prime loan, particularly if the home had increased in value, thus lowering the loan-to-value ratio. Borrowers with spotty payment records but who were generally current could refinance into another subprime loan, and borrowers who had made payments on time but who wanted to take extra cash out of the house such that they could not meet prime underwriting standards would also refinance with a subprime loan. If the borrower had a poor payment history and was in default, the borrower would usually seek to sell the house, particularly in markets that had seen home price appreciation, or face foreclosure action.

The big increases in the inventories of homes for sale, due to wide-scale overbuilding and the population and job declines in the Midwest, have led to home price declines that have upset these potential outcomes. First, general credit conditions tightened and borrowers found they may no longer be eligible to refinance. For example, borrowers who had made all of their payments found that they could not refinance due to increases in their loan to value ratios caused by falling home prices, and even if they had made their payments on

2 These offers are similar to the initial zero-percent interest offers on credit cards or large purchases made on credit.

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time, their total debt to income ratios might preclude them from refinancing with a prime mortgage. Borrowers with spotty credit records found that they did not have home price appreciation to fall back on if they wanted to sell the house and there were no longer lenders willing to make a loan to them because there were no longer investors willing to purchase loans from individuals with their level of risk, or the lenders simply were no longer in business.[3] This was particularly true for subprime borrowers who had relied on repeated cash-out refinancings to support lifestyles they otherwise could not afford or to pay off credit cards. This quandary has led to the many calls for the mortgage industry and investors in these mortgages to modify them until the current situation has stabilized.

The mortgage industry has historically used modifications sparingly[4] due to the degree to which they can quickly destroy borrower discipline and result in some combination of higher borrowing costs for all borrowers and tighter credit standards for granting loans. Even in the current environment, loan modification of ARMs in the form of freezing interest rates can be seen as rewarding borrowers who decided to take a risk and take out loans with lower initial payments than what they would have been required to make with fixed rate, fully amortizing loans

The Current Situation and the Measurement of the Level of Loan Modifications

The current environment of rapidly declining home prices due to an over-supply of homes in some areas, particularly in states like California and Florida that have large numbers of the subprime ARM loans in the country, have changed the calculation for investors of wholesale modification of adjustable rate loans. Given that foreclosing on these loans in the adverse home price environment where they are located would greatly increase losses to the investors in those loans and to lenders who hold those loans in portfolio,[5] mortgage

3 It is important to remember that the default rate among subprime lenders has been far greater than the default rate among subprime borrowers.

4 The one possible exception is with subprime fixed mortgages where it is common to add missed payments to the end of the mortgage. In addition, in the wake of Hurricane Katrina, numerous mortgages were modified.

5 The fundamental problem is that the supply of homes is relatively inelastic, that is, the supply of homes does not respond quickly to changes in home prices. This leads to rapid home price increases when demand increases and rapid home price declines when demand falls. On the demand side, household formation is relatively inelastic to changes in home prices so

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servicers are attempting to maintain the cash flows on those loans through more extensive use of modifications. In addition, a number of policy makers, regulators and others have concluded that the broader public purpose of slowing the cycle of home price declines and foreclosures outweighs the long-term costs of wholesale modifications.

Given the investor, public, regulatory, and political interest in the degree of loan modifications being done on subprime ARM loans, much attention has been given to the level of modifications, but there has been little information against which to judge the number of modifications being done. For example, Moody's issued a report in September 2007[6] that effectively called the industry to task for modifying only 1 percent of the subprime ARM loans that are resetting. Although subsequent reports by Moody's have given a more complete picture, this type of analysis tends to minimize the amount of help being given borrowers because it limits the numerator to loan modifications and excludes other types of assistance offered to borrowers to either keep them in their homes or relieve them of the financial burden if they decide to move out. Borrower assistance can come in the form of loan modifications or repayment plans that are traditionally more common, particularly with FHA loans. In addition, deed in lieu transactions allow the borrower to turn the property over to the lender in exchange for complete extinguishment of the debt. In short sale transactions, the borrower is allowed to sell the home to a third party for less than the outstanding mortgage, usually with forgiveness of the remaining balance. In both cases the borrower is relieved of the loan without a foreclosure filing against their credit records.

The other problem with the Moody's analysis is that it uses at the denominator the complete universe of subprime ARMs whose rates are resetting in a particular period. Only a limited number of borrowers with subprime ARMs can be helped or need to be helped. A significant percentage refinance on their own prior to the rate reset. A significant percentage default before the rate reset for reasons completely unrelated to the rate reset. These reasons can include the loss of a job, health issues, a divorce, the death of one of the income earners in the household, or becoming overextended with other credit like credit cards or car pay-

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price-influenced demand would come from attracting credit worthy buyers from rentals and buyers wanting to buy for investment purposes. Both are unlikely to come in the market in a big way until there are signs that the decline in home prices has ended.

6 Drucker, Michael R and Fricke, William 2007, "Moody's Subprime Mortgage Servicer Survey on Loan Modifications", Structured Finance, New York, NY: Moody's Investors Service.

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ments. If they cannot make their current low payments, freezing payments at the pre-rate reset levels will not help those borrowers. A more appropriate measure is not to look the total number of borrowers helped versus all loans outstanding but the numbers helped relative to the number that go into foreclosure. But even looking at the foreclosure number by itself is not a good measure because a number of borrowers facing foreclosure cannot be helped by a payment modification plan. Among these are:

Investors — In a number of cases the borrower does not occupy the house but has bought it either to speculate on increasing home prices or as a business transaction hoping to make a profit on the combination of rental income and price appreciation. As has been seen in California, Florida, Nevada, Arizona and elsewhere, these investors are among the first to default if they see that home prices are falling and there is little chance of recouping their money, much less making a big profit. Rather than throwing good money after bad by continuing to make payments, these borrowers will stop making payments rather abruptly.

Borrowers who do not respond to lenders or who cannot be located — Some borrowers simply will not respond to repeated attempts by lenders to contact them to see if the situation can be resolved through loan modification or other means. Contact attempts include phone calls and letters, but some borrowers cannot be located at all, which happen when someone loses a job and moves to find employment elsewhere. It is not unusual for mortgage servicing representatives to find the house vacant, evidence that the borrower has already given up on the house and the loan.

Defaulted despite a previous loan modification or repayment plan — Many borrowers with whom lenders establish a loan repayment plan or modification cannot live up to the modified terms. Most such plans deal with borrowers who have had a short-term setback, such as being between jobs or dealing with a temporary disability. While these borrowers may be able to make their mortgage payments going forward, they are clearly not able to catch up with the missed payments. In a typical case, a borrower would agree to a plan whereby any delinquent payments will be spread over some period of time. The borrower is expected to remain current and make the additional required payments.

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This rest of this paper provides information on the actions lenders took to assist borrowers in the third quarter of 2007, including loan modifications, repayment plans, deed in lieu transactions and short sales. However, it first looks at the extent the other circumstances discussed above essentially eliminated a number of borrowers from possible loan modification. It looks at the number of foreclosures attributable to borrowers who do not occupy the properties, borrowers who cannot be located or won't respond to lenders and borrowers who have already failed a previous repayment plan, and then estimates the number of foreclosure actions started relative to the number of loan modifications, repayment plans and other actions taken by mortgage servicers.

Data

Mortgage servicers[7] provided information to the Mortgage Bankers Association approximately 33 million loans serviced during the 3rd quarter of 2007 representing approximately 62 percent of the loans outstanding. The numbers are broken down as follows, with FHA loans included in the prime loan categories:

Subprime ARM loans	2.1 million
Subprime fixed-rate loans	2.1 million
Prime ARM loans	4.8 million
Prime fixed-rate loans	23.8 million

7 A mortgage servicer is a firm that collects payments from borrowers and passes on the payments to the investor in that mortgage. The mortgage servicer may or may not be part of the same institution that owns the mortgage. In addition to sending the payments to the investors, calculating the rate changes for adjustable-rate mortgages and handling other tasks like making tax and insurance payments out of escrow accounts and providing year-end tax statements for borrowers, servicers are responsible for all of the collection and foreclosure activities surrounding delinquent loans.

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Mortgage servicers were asked to provide information on the number of formal, written repayment plans established, loan modifications put in place, deed in lieu transactions and short sales during the quarter.[8] Mortgage servicers were also asked to provide information on foreclosure actions filed during the third quarter, as well as some of the circumstances surrounding those foreclosures. Servicers were asked to identify the number of foreclosures filed on investor-owned properties, that is, properties where the owner of the property did not live in it but bought it for speculative purposes or to rent it. Since some number of borrowers will falsely claim at the time the loan is originated that they will occupy the house in order to secure a lower interest rate, servicers were instead asked to use a metric that has proven to be a better measure of investor properties -- identify investors as those cases where the property address was not the same as the billing address. Servicers were also asked to identify those cases where borrowers either would not respond to repeated attempts by lenders to contact them, or who could not be located at all. It is not uncommon for borrowers to simply leave the house without notifying the lender. Finally, lenders were asked to provide information on the number of foreclosures where the borrower already had a repayment plan or loan modification in place but could not perform according to the agreed upon terms and defaulted again.

Since the data cover about 62% of the market, the numbers were adjusted to reflect the estimated level of industry activity. In order to be conservative with the estimates, servicers with particularly high levels of loan modifications or repayment plans were excluded from the industry averages and loan totals when the numbers were grossed up, with their numbers added separately to the industry count.. It is entirely possible that the actual numbers for the third quarter are higher than those reported here, but it is not likely that they are lower.

8 Such plans were counted only if a formal written agreement was executed with the borrower. Informal plans, such a verbal promise to bring the mortgage current over the next few months were not counted.

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Results

Of the foreclosure actions started in the third quarter of 2007,[9] 18 percent were on properties that were not occupied by the owners, 23 percent were in cases where the borrower did not respond or could not be located, and 29 percent were cases where the borrower defaulted despite already having a repayment plan or loan modification in place. Tables 1 through 5 give the percentages by loan type for all of the states and the US total. The results show, for example, that the degree to which invest investor-owned properties drove foreclosures in the third quarter differed widely by state and by loan type. They ranged from a high of 35 percent of prime ARM foreclosures in Montana to a low of 6 percent of prime fixed-rate foreclosures in South Dakota. For the nation, investor loans comprised 18 percent of subprime ARM foreclosures, 28 percent of subprime fixed-rate foreclosures, 18 percent of prime ARM foreclosures and 14 percent of prime fixed-rate foreclosures. Table 6 shows, for example, that while 11 percent of foreclosures on prime ARM and prime fixed-rate loans were on non-owner occupied properties, the percentages for subprime loans were almost double that — 19 percent for subprime ARMs and 20 percent for subprime fixed-rate. In Ohio, a state that has had some of the highest foreclosure rates in the nation, investor-owned properties accounted for 21 percent of subprime ARM foreclosures and 34 percent of subprime fixed-rate foreclosures, versus 18 percent of prime ARM and 14 percent of prime fixed-rate foreclosures. Nevada had among the highest investor-owned share of foreclosures, with investors accounting for 36 percent of subprime fixed-rate foreclosures, 18 percent of subprime ARM foreclosures, 24 percent of prime ARM foreclosures and 14 percent of prime fixed-rate foreclosures.

Borrowers who could not be located or who would not respond to repeated attempts by lenders to contact them accounted for 23 percent of all foreclosures in the third quarter, 21 percent of subprime ARM foreclosures, 21 percent of subprime ARM foreclosures, 17 percent of prime ARM foreclosures and 33 percent of prime fixed-rate foreclosures. Thus, as a percent of foreclosures, the inability to get a borrower to respond to a mortgage servicer

9 The actual number of foreclosures started was likely closer to 400,000 based on the MBA's National Delinquency Survey. However, these foreclosures were on loans that cannot be identified by type as to fixed or adjustable rate and are therefore excluded. In addition, VA loans were not included but FHA loans were lumped into the prime loan categories.

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is a much bigger problem for prime-fixed rate borrowers than for subprime borrowers. Again the results differed widely by state and loan type. The highest was 69 percent for prime fixed-rate foreclosures in Oklahoma versus a low of 7 percent of prime ARM foreclosures in Wisconsin. Table 7 shows that in Ohio and Michigan, 25 and 26 percent respectively of all foreclosures started in those states were for borrowers who would not respond to repeated attempts to contact them or could not be located.

Borrowers who had worked with their lenders and established loan modification or formal repayment plans, and then failed to perform according to those plans, accounted for 29 percent of all foreclosures in the third quarter. The inability of borrowers to meet the terms of their repayment plans or loan modifications accounted for 40 percent of subprime ARM foreclosures, 37 percent of subprime fixed foreclosures, 17 percent of prime ARM foreclosures and 14 percent of prime fixed foreclosures. Table 8 shows that the states of Vermont, North Dakota, New Mexico and Arkansas, with little else in common, had the highest shares of foreclosures due to the inability of borrowers to live up to prior plans.

Tables 9 through 13 present the information on the number of loan modifications, repayment plans, deed in lieu transactions and short sales, and compare those numbers with the number of foreclosures started. During the third quarter, mortgage servicers put in place approximately 183 thousand repayment plans and modified the rates or terms on approximately 54 thousand loans. Lenders modified approximately 13 thousand subprime ARM loans, 15 thousand subprime fixed rate loans, 4 thousand prime ARM loans and 21 thousand prime fixed-rate loans. In addition, servicers negotiated formal repayment plans with approximately 91 thousand subprime ARM borrowers, 30 thousand subprime fixed-rate borrowers, 37 thousand prime ARM borrowers and 25 thousand prime fixed-rate borrowers. During this period the industry did approximately one thousand deed in lieu transactions and nine thousand short sales.

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In an effort to put these numbers into context, Tables 9 through 13 also provide a comparison with the repayment plan and loan modification numbers. They show a breakdown of the number of foreclosures started net of those that clearly could not be helped due to reasons already discussed — investor-owned, borrower would not respond or could not be located, or borrower failed to live up to an agreement already in place. As previously discussed, the percentages were adjusted downward to eliminate double counting for those borrowers who fell into more than one category. Therefore, while an estimated 166 thousand subprime ARM foreclosures were started during the third quarter, only 50 thousand did not fall into one of those three categories. In comparison, about 90 thousand repayment plans were renegotiated and 13 thousand loan modifications were done, for a total of 103 thousand. Of the net 50 thousand foreclosures, many of these likely occurred due to the traditional reasons for default, loss of job, divorce, illness or excessive debt burden relative to income, not just the impact of rate resets, thus eliminating any possible benefit of a rate freeze.

For subprime fixed loans, only about 12 thousand foreclosures did not fall into one of the categories, versus about 30 thousand repayment plans and 15 thousand loan modifications. For the prime ARM loans, the net foreclosure number was about 41 thousand versus 37 thousand repayment plans and 4 thousand loan modifications. For prime fixed-rate loans, the net foreclosure number was about 46 thousand versus 25 thousand repayment plans and 21 thousand loan modifications.

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Conclusion

The mortgage industry took major steps during the third quarter in helping those borrowers who could be helped. The numbers of loan modifications, negotiated repayment plans, short sales and deed in lieu transactions are large and compare favorably with the number of foreclosure actions started, particularly when those foreclosures are adjusted to remove the borrowers who clearly could not be helped. It is likely that the number of loan modifications for subprime ARMs will continue to grow as the number of subprime ARMs with rates resetting peak in the first half of 2008. More importantly, during the third and fourth quarters of 2007, several legal, accounting and regulatory impediments to more widespread modifications were removed, which should also lead more increases in the loan modification numbers going forward.

The current situation in the housing market is presenting major challenges to borrowers, mortgage servicers, investors in mortgages and regulators. In many ways, the way in which the industry and regulators respond will determine the viability of the mortgage finance system for years to come. It appears that, based on these numbers, the mortgage industry is doing its part to help those borrowers who can be helped.

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TABLE 1- Factors Impacting Foreclosure Starts
All Loan Types - 2007 3rd Quarter

	Not Occupied by Owner	Borrower Would Not Respond	Borrower Defaulted Despite Previous Plan	Total*
Alabama	18%	23%	27%	60%
Alaska	14%	36%	27%	73%
Arizona	22%	23%	23%	59%
Arkansas	18%	24%	41%	75%
California	16%	20%	29%	57%
Colorado	20%	25%	27%	63%
Connecticut	13%	19%	34%	61%
Delaware	16%	21%	31%	60%
District of Columbia	16%	27%	34%	70%
Florida	22%	24%	27%	65%
Georgia	19%	28%	28%	65%
Hawaii	18%	16%	29%	57%
Idaho	17%	30%	28%	67%
Illinois	18%	25%	21%	56%
Indiana	19%	23%	32%	67%
Iowa	18%	28%	34%	72%
Kansas	19%	28%	24%	62%
Kentucky	16%	23%	29%	63%
Louisiana	16%	28%	30%	65%
Maine	13%	19%	42%	70%
Maryland	14%	24%	33%	65%
Massachusetts	16%	22%	29%	60%
Michigan	21%	28%	29%	66%
Minnesota	19%	25%	26%	60%
Mississippi	14%	25%	37%	70%
Missouri	19%	24%	29%	63%
Montana	17%	19%	20%	52%
Nebraska	14%	33%	34%	76%
Nevada	22%	19%	21%	53%
New Hampshire	12%	27%	33%	67%
New Jersey	18%	21%	22%	53%
New Mexico	12%	31%	44%	83%
New York	20%	20%	27%	59%
North Carolina	16%	19%	34%	64%
North Dakota	13%	23%	47%	80%
Ohio	22%	25%	28%	65%
Oklahoma	18%	47%	24%	80%
Oregon	19%	25%	32%	68%
Pennsylvania	15%	21%	31%	60%
Rhode Island	16%	19%	39%	69%
South Carolina	16%	24%	29%	64%
South Dakota	11%	24%	19%	49%
Tennessee	16%	23%	32%	65%
Texas	18%	27%	31%	68%
Utah	17%	21%	30%	61%
Vermont	10%	19%	54%	80%
Virginia	15%	22%	24%	53%
Washington	16%	22%	34%	65%
West Virginia	15%	29%	34%	72%
Wisconsin	18%	21%	23%	56%
Wyoming	18%	30%	31%	72%
Total USA	18%	23%	29%	63%

*Columns do not add to the total because some borrowers fell into more than one category. For example, some borrowers were both investors and would not respond to mortgage servicers.

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TABLE 2- Factors Impacting Foreclosure Starts
Subprime ARMs - 2007 3rd Quarter

	Not Occupied by Owner	Borrower Would Not Respond	Borrower Defaulted Despite Previous Plan	Total*
Alabama	13%	18%	41%	66%
Alaska	14%	22%	45%	77%
Arizona	21%	23%	30%	63%
Arkansas	14%	13%	58%	80%
California	19%	22%	36%	67%
Colorado	22%	25%	37%	71%
Connecticut	12%	17%	42%	64%
Delaware	9%	14%	43%	62%
District of Columbia	15%	23%	45%	75%
Florida	21%	22%	39%	72%
Georgia	18%	18%	43%	71%
Hawaii	19%	17%	41%	70%
Idaho	19%	29%	32%	70%
Illinois	19%	26%	26%	61%
Indiana	17%	18%	44%	73%
Iowa	13%	22%	50%	80%
Kansas	19%	24%	34%	68%
Kentucky	14%	17%	43%	69%
Louisiana	11%	19%	42%	66%
Maine	13%	13%	57%	78%
Maryland	13%	20%	44%	70%
Massachusetts	16%	24%	38%	69%
Michigan	18%	20%	43%	73%
Minnesota	19%	24%	37%	71%
Mississippi	14%	19%	50%	78%
Missouri	17%	24%	37%	68%
Montana	14%	24%	35%	66%
Nebraska	13%	19%	51%	78%
Nevada	20%	23%	30%	62%
New Hampshire	11%	23%	49%	77%
New Jersey	18%	28%	31%	67%
New Mexico	10%	12%	60%	80%
New York	17%	25%	34%	66%
North Carolina	14%	13%	52%	74%
North Dakota	11%	9%	65%	84%
Ohio	21%	22%	40%	74%
Oklahoma	13%	22%	37%	65%
Oregon	20%	17%	40%	69%
Pennsylvania	12%	20%	39%	66%
Rhode Island	16%	18%	49%	78%
South Carolina	13%	21%	41%	69%
South Dakota	10%	22%	35%	60%
Tennessee	16%	19%	45%	72%
Texas	16%	19%	43%	70%
Utah	15%	15%	43%	67%
Vermont	8%	9%	68%	83%
Virginia	14%	22%	34%	61%
Washington	17%	19%	44%	71%
West Virginia	12%	22%	44%	74%
Wisconsin	19%	25%	32%	67%
Wyoming	11%	26%	43%	72%
Total USA	18%	21%	40%	70%

*Columns do not add to the total because some borrowers fell into more than one category. For example, some borrowers were both investors and would not respond to mortgage servicers.

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TABLE 3- Factors Impacting Foreclosure Starts
Subprime Fixed-Rate - 2007 3rd Quarter

	Not Occupied by Owner	Borrower Would Not Respond	Borrower Defaulted Despite Previous Plan	Total*
Alabama	28%	18%	40%	74%
Alaska	18%	26%	43%	83%
Arizona	28%	19%	33%	69%
Arkansas	27%	18%	35%	70%
California	20%	17%	38%	68%
Colorado	37%	21%	35%	81%
Connecticut	21%	19%	39%	73%
Delaware	33%	24%	38%	80%
District of Columbia	20%	16%	49%	78%
Florida	27%	22%	33%	73%
Georgia	32%	18%	40%	78%
Hawaii	13%	16%	38%	59%
Idaho	21%	22%	46%	76%
Illinois	33%	23%	24%	67%
Indiana	35%	23%	29%	74%
Iowa	24%	18%	43%	75%
Kansas	31%	23%	33%	74%
Kentucky	24%	19%	39%	73%
Louisiana	24%	23%	36%	73%
Maine	23%	9%	47%	74%
Maryland	24%	20%	39%	75%
Massachusetts	27%	22%	30%	69%
Michigan	36%	29%	31%	78%
Minnesota	29%	25%	33%	75%
Mississippi	19%	16%	51%	78%
Missouri	29%	20%	37%	75%
Montana	31%	17%	24%	65%
Nebraska	15%	8%	58%	77%
Nevada	33%	23%	24%	64%
New Hampshire	23%	20%	37%	72%
New Jersey	32%	20%	26%	68%
New Mexico	20%	26%	51%	88%
New York	32%	20%	35%	73%
North Carolina	32%	18%	40%	77%
North Dakota	12%	15%	66%	90%
Ohio	34%	26%	34%	78%
Oklahoma	29%	40%	32%	90%
Oregon	28%	26%	34%	76%
Pennsylvania	25%	18%	39%	72%
Rhode Island	16%	16%	46%	73%
South Carolina	24%	15%	43%	74%
South Dakota	37%	29%	23%	71%
Tennessee	18%	18%	49%	78%
Texas	25%	17%	42%	74%
Utah	37%	15%	31%	69%
Vermont	10%	12%	56%	74%
Virginia	25%	21%	40%	74%
Washington	25%	23%	34%	70%
West Virginia	25%	25%	44%	80%
Wisconsin	28%	22%	27%	67%
Wyoming	35%	16%	30%	73%
Total USA	28%	21%	37%	74%

*Columns do not add to the total because some borrowers fall into more than one category. For example,

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TABLE 4 - Factors Impacting Foreclosure Starts
Prime ARMs - 2007 3rd Quarter

	Not Occupied by Owner	Borrower Would Not Respond	Borrower Defaulted Despite Previous Plan	Total*
Alabama	27%	16%	16%	53%
Alaska	23%	38%	13%	58%
Arizona	26%	18%	16%	55%
Arkansas	25%	26%	35%	76%
California	11%	14%	17%	39%
Colorado	17%	20%	16%	50%
Connecticut	18%	16%	16%	46%
Delaware	24%	13%	18%	53%
District of Columbia	29%	20%	9%	51%
Florida	27%	20%	14%	54%
Georgia	22%	24%	14%	49%
Hawaii	22%	9%	16%	43%
Idaho	24%	26%	12%	50%
Illinois	15%	19%	16%	46%
Indiana	18%	21%	27%	60%
Iowa	21%	23%	26%	64%
Kansas	11%	20%	24%	47%
Kentucky	20%	20%	11%	47%
Louisiana	24%	24%	10%	53%
Maine	16%	20%	29%	60%
Maryland	12%	22%	17%	48%
Massachusetts	11%	12%	14%	34%
Michigan	18%	19%	20%	50%
Minnesota	20%	16%	17%	40%
Mississippi	17%	31%	23%	64%
Missouri	21%	14%	19%	44%
Montana	35%	22%	4%	52%
Nebraska	14%	46%	26%	83%
Nevada	24%	13%	13%	45%
New Hampshire	12%	25%	15%	47%
New Jersey	13%	15%	11%	36%
New Mexico	19%	28%	39%	78%
New York	15%	16%	13%	40%
North Carolina	19%	14%	25%	50%
North Dakota	21%	24%	34%	72%
Ohio	18%	18%	15%	45%
Oklahoma	31%	18%	14%	57%
Oregon	17%	24%	16%	45%
Pennsylvania	13%	22%	22%	49%
Rhode Island	18%	13%	10%	37%
South Carolina	20%	23%	16%	51%
South Dakota	14%	14%	14%	38%
Tennessee	20%	21%	14%	50%
Texas	28%	18%	27%	63%
Utah	23%	19%	18%	55%
Vermont	19%	25%	42%	80%
Virginia	14%	19%	8%	35%
Washington	13%	17%	21%	46%
West Virginia	18%	15%	29%	59%
Wisconsin	12%	7%	13%	31%
Wyoming	20%	20%	0%	40%
Total USA	18%	17%	17%	46%

* Columns do not add to the total because some borrowers fall into more than one category. For example, some borrowers were both investors and would not respond to mortgage servicers.

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TABLE 5 - Factors Impacting Foreclosure Starts
Prime Fixed Rate - 2007 3rd Quarter

	Not Occupied by Owner	Borrower Would Not Respond	Borrower Defaulted Despite Previous Plan	Total*
Alabama	13%	31%	8%	47%
Alaska	13%	44%	17%	70%
Arizona	16%	28%	13%	50%
Arkansas	17%	46%	14%	68%
California	11%	23%	15%	44%
Colorado	13%	29%	15%	52%
Connecticut	10%	26%	18%	50%
Delaware	13%	32%	10%	47%
District of Columbia	9%	44%	16%	67%
Florida	18%	33%	11%	54%
Georgia	15%	37%	14%	60%
Hawaii	15%	18%	8%	38%
Idaho	12%	35%	21%	64%
Illinois	9%	26%	11%	43%
Indiana	13%	31%	18%	56%
Iowa	18%	34%	17%	63%
Kansas	17%	29%	14%	56%
Kentucky	14%	30%	15%	54%
Louisiana	14%	34%	16%	59%
Maine	10%	33%	22%	60%
Maryland	11%	37%	14%	56%
Massachusetts	12%	25%	15%	46%
Michigan	17%	35%	13%	57%
Minnesota	13%	32%	14%	52%
Mississippi	11%	36%	14%	57%
Missouri	17%	30%	11%	51%
Montana	12%	17%	12%	40%
Nebraska	14%	48%	18%	73%
Nevada	14%	21%	8%	35%
New Hampshire	9%	36%	16%	58%
New Jersey	11%	13%	10%	31%
New Mexico	10%	55%	24%	85%
New York	12%	15%	10%	33%
North Carolina	10%	29%	12%	47%
North Dakota	13%	41%	24%	73%
Ohio	14%	28%	13%	49%
Oklahoma	12%	69%	10%	85%
Oregon	12%	41%	23%	71%
Pennsylvania	11%	24%	19%	50%
Rhode Island	16%	26%	17%	52%
South Carolina	12%	33%	13%	54%
South Dakota	6%	25%	13%	43%
Tennessee	15%	31%	11%	51%
Texas	14%	40%	17%	65%
Utah	10%	30%	20%	56%
Vermont	13%	45%	21%	74%
Virginia	11%	28%	9%	42%
Washington	11%	30%	21%	59%
West Virginia	14%	43%	16%	68%
Wisconsin	11%	20%	10%	38%
Wyoming	12%	48%	21%	76%
Total USA	14%	33%	14%	55%

*Columns do not add to the total because some borrowers fell into more than one category. For example, some borrowers were both investors and would not respond to mortgage servicers.

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TABLE 6 - Non-Owner Occupied Portion of Foreclosures Started
2007 Third Quarter

	PRIME ARM	PRIME FIXED	SUBPRIME ARM	SUBPRIME FIXED	ALL LOANS
Alabama	27%	13%	13%	28%	18%
Alaska	23%	13%	14%	18%	14%
Arizona	26%	16%	21%	28%	22%
Arkansas	25%	17%	14%	27%	18%
California	11%	11%	19%	20%	16%
Colorado	17%	13%	22%	37%	20%
Connecticut	18%	10%	12%	21%	13%
Delaware	24%	13%	9%	33%	16%
District of Columbia	29%	9%	15%	20%	16%
Florida	27%	18%	21%	27%	22%
Georgia	22%	15%	18%	32%	19%
Hawaii	22%	15%	19%	13%	18%
Idaho	24%	12%	19%	21%	17%
Illinois	15%	9%	19%	33%	18%
Indiana	18%	13%	17%	35%	19%
Iowa	21%	18%	13%	24%	18%
Kansas	11%	17%	19%	31%	19%
Kentucky	20%	14%	14%	24%	16%
Louisiana	24%	14%	11%	24%	16%
Maine	16%	10%	13%	23%	13%
Maryland	12%	11%	13%	24%	14%
Massachusetts	11%	12%	16%	27%	16%
Michigan	18%	17%	18%	36%	21%
Minnesota	20%	13%	19%	29%	19%
Mississippi	17%	11%	14%	19%	14%
Missouri	21%	17%	17%	29%	19%
Montana	35%	12%	14%	31%	17%
Nebraska	14%	14%	13%	15%	14%
Nevada	24%	14%	20%	33%	22%
New Hampshire	12%	9%	11%	23%	12%
New Jersey	13%	11%	18%	32%	18%
New Mexico	19%	10%	10%	20%	12%
New York	15%	12%	17%	32%	20%
North Carolina	19%	10%	14%	32%	16%
North Dakota	21%	13%	11%	12%	13%
Ohio	18%	14%	21%	34%	22%
Oklahoma	31%	12%	13%	29%	18%
Oregon	17%	12%	20%	28%	19%
Pennsylvania	13%	11%	12%	25%	15%
Rhode Island	18%	16%	16%	16%	16%
South Carolina	20%	12%	13%	24%	16%
South Dakota	14%	6%	10%	37%	11%
Tennessee	20%	15%	16%	18%	16%
Texas	28%	14%	16%	25%	18%
Utah	23%	10%	15%	37%	17%
Vermont	19%	13%	8%	10%	10%
Virginia	14%	11%	14%	25%	15%
Washington	13%	11%	17%	25%	16%
West Virginia	18%	14%	12%	25%	15%
Wisconsin	12%	11%	19%	28%	18%
Wyoming	20%	12%	11%	35%	18%
USA	18%	14%	18%	28%	18%

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TABLE 7 - No Response from Borrower Portion of Foreclosures Started - 2007 Third Quarter

	PRIME ARM	PRIME FIXED	SUBPRIME ARM	SUBPRIME FIXED	ALL LOANS
Alabama	16%	17%	18%	18%	23%
Alaska	38%	31%	22%	26%	36%
Arizona	18%	44%	23%	19%	23%
Arkansas	26%	28%	13%	18%	24%
California	14%	46%	22%	17%	20%
Colorado	20%	23%	25%	21%	25%
Connecticut	16%	29%	17%	19%	19%
Delaware	13%	25%	14%	24%	21%
District of Columbia	20%	32%	23%	16%	27%
Florida	20%	44%	22%	22%	24%
Georgia	24%	33%	18%	18%	26%
Hawaii	9%	37%	17%	16%	16%
Idaho	26%	18%	29%	22%	30%
Illinois	19%	35%	26%	23%	25%
Indiana	21%	26%	18%	23%	23%
Iowa	23%	31%	22%	18%	26%
Kansas	20%	34%	24%	23%	26%
Kentucky	20%	29%	17%	19%	23%
Louisiana	24%	30%	19%	23%	26%
Maine	20%	34%	13%	9%	19%
Maryland	22%	33%	20%	20%	24%
Massachusetts	12%	37%	24%	22%	22%
Michigan	19%	25%	20%	29%	26%
Minnesota	16%	35%	24%	25%	25%
Mississippi	31%	32%	19%	16%	25%
Missouri	14%	36%	24%	20%	24%
Montana	22%	30%	24%	17%	19%
Nebraska	46%	17%	19%	8%	33%
Nevada	13%	48%	23%	23%	19%
New Hampshire	25%	21%	23%	20%	27%
New Jersey	15%	36%	28%	20%	21%
New Mexico	28%	13%	12%	26%	31%
New York	16%	55%	25%	20%	20%
North Carolina	14%	15%	13%	18%	19%
North Dakota	24%	29%	9%	15%	23%
Ohio	18%	41%	22%	26%	25%
Oklahoma	18%	28%	22%	40%	47%
Oregon	24%	69%	17%	26%	25%
Pennsylvania	22%	41%	20%	18%	21%
Rhode Island	13%	24%	18%	16%	19%
South Carolina	23%	26%	21%	15%	24%
South Dakota	14%	33%	22%	29%	24%
Tennessee	21%	25%	19%	18%	23%
Texas	18%	31%	19%	17%	27%
Utah	19%	40%	15%	15%	21%
Vermont	25%	30%	9%	12%	19%
Virginia	19%	45%	22%	21%	22%
Washington	17%	28%	19%	23%	22%
West Virginia	15%	30%	22%	25%	29%
Wisconsin	7%	43%	25%	22%	21%
Wyoming	20%	20%	26%	16%	30%
USA	17%	33%	21%	21%	23%

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TABLE 8 - Borrower Failed previous Plan Portion of Foreclosures Started - 2007 Third Quarter

	PRIME ARM	PRIME FIXED	SUBPRIME ARM	SUBPRIME FIXED	ALL LOANS
Alabama	16%	8%	41%	40%	27%
Alaska	13%	17%	45%	43%	27%
Arizona	16%	13%	30%	33%	23%
Arkansas	35%	14%	58%	35%	41%
California	17%	15%	36%	38%	29%
Colorado	18%	15%	37%	35%	27%
Connecticut	16%	18%	42%	39%	34%
Delaware	18%	10%	43%	38%	31%
District of Columbia	9%	18%	45%	49%	34%
Florida	14%	11%	39%	33%	27%
Georgia	14%	14%	43%	40%	28%
Hawaii	16%	8%	41%	38%	29%
Idaho	12%	21%	32%	46%	28%
Illinois	16%	11%	26%	24%	21%
Indiana	27%	18%	44%	29%	32%
Iowa	26%	17%	50%	43%	34%
Kansas	24%	14%	34%	33%	24%
Kentucky	11%	15%	43%	39%	29%
Louisiana	10%	16%	42%	36%	30%
Maine	29%	22%	57%	47%	42%
Maryland	17%	14%	44%	39%	33%
Massachusetts	14%	15%	38%	30%	29%
Michigan	20%	13%	43%	31%	29%
Minnesota	17%	14%	37%	33%	26%
Mississippi	23%	14%	50%	51%	37%
Missouri	19%	11%	37%	37%	29%
Montana	4%	12%	35%	24%	20%
Nebraska	28%	18%	51%	58%	34%
Nevada	13%	8%	30%	24%	21%
New Hampshire	15%	16%	49%	37%	33%
New Jersey	11%	10%	31%	26%	22%
New Mexico	39%	24%	60%	51%	44%
New York	13%	10%	34%	35%	27%
North Carolina	25%	12%	52%	40%	34%
North Dakota	34%	24%	65%	66%	47%
Ohio	15%	13%	40%	34%	28%
Oklahoma	14%	10%	37%	32%	24%
Oregon	16%	23%	40%	34%	32%
Pennsylvania	22%	19%	39%	39%	31%
Rhode Island	10%	17%	49%	46%	39%
South Carolina	16%	13%	41%	43%	29%
South Dakota	14%	13%	35%	23%	19%
Tennessee	14%	11%	45%	49%	32%
Texas	27%	17%	43%	42%	31%
Utah	18%	20%	43%	31%	30%
Vermont	42%	21%	68%	56%	54%
Virginia	8%	9%	34%	40%	24%
Washington	21%	21%	44%	34%	34%
West Virginia	29%	16%	44%	44%	34%
Wisconsin	13%	10%	32%	27%	23%
Wyoming	0%	21%	43%	30%	31%
USA	17%	14%	40%	37%	29%

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TABLE 9 - Estimated Modifications and Foreclosures - All Loans

	Repayment Plans	Loan Modifications	Total	Deed in Lieu	Short Sales	Foreclosures Started*	Net Forclosures started*
Alabama	1,785	742	2,527	6	39	3,960	1,655
Alaska	733	167	899	0	1	330	92
Arizona	4,326	900	5,226	41	288	10,222	4,092
Arkansas	2,348	269	2,617	3	25	1,478	388
California	23,579	4,450	28,030	155	1,729	63,877	27,679
Colorado	3,201	1,300	4,501	30	625	8,663	3,293
Connecticut	2,646	572	3,218	7	112	3,661	1,454
Delaware	459	122	580	0	23	1,103	470
DC	561	100	661	0	17	502	160
Florida	16,507	3,279	19,786	155	656	44,150	15,761
Georgia	8,142	3,122	11,264	25	280	15,887	5,684
Hawaii	444	65	509	2	22	732	304
Idaho	871	288	1,159	4	51	1,072	369
Illinois	5,362	1,786	7,148	50	367	17,076	7,810
Indiana	5,090	1,562	6,652	22	239	11,954	4,240
Iowa	1,915	830	2,745	21	80	2,376	710
Kansas	1,011	409	1,420	10	74	1,994	784
Kentucky	1,676	659	2,335	11	130	3,855	1,474
Louisiana	2,225	925	3,150	3	91	3,392	1,239
Maine	1,460	213	1,673	3	48	991	294
Maryland	4,933	838	5,771	5	105	6,274	2,260
Massachusetts	3,252	917	4,169	14	241	7,467	3,174
Michigan	7,379	3,244	10,623	153	388	22,806	8,186
Minnesota	3,036	943	3,978	23	295	8,627	3,508
Mississippi	2,220	682	2,901	3	57	2,400	721
Missouri	3,390	1,074	4,464	15	133	6,911	2,710
Montana	302	111	412	2	12	366	165
Nebraska	1,953	678	2,632	4	42	1,265	295
Nevada	2,336	666	3,002	26	202	7,424	3,337
New Hampshire	792	335	1,127	4	47	1,388	458
New Jersey	3,427	983	4,410	13	187	9,241	4,593
New Mexico	2,262	404	2,666	1	47	1,007	170
New York	6,075	1,481	7,556	18	241	14,531	6,595
North Carolina	4,730	1,403	6,133	19	206	8,366	3,263
North Dakota	3,006	401	3,407	0	5	141	26
Ohio	7,221	3,135	10,356	140	607	20,705	7,940
Oklahoma	1,375	602	1,977	8	91	2,604	604
Oregon	1,381	349	1,730	0	92	2,138	719
Pennsylvania	5,995	2,003	7,998	24	204	9,682	3,929
Rhode Island	886	142	1,028	0	51	1,600	523
South Carolina	2,976	1,048	4,024	2	100	4,888	1,836
South Dakota	131	60	191	0	13	312	154
Tennessee	3,603	1,475	5,078	3	124	6,422	2,311
Texas	12,233	5,555	17,788	50	708	20,392	6,499
Utah	1,083	330	1,413	5	107	1,863	705
Vermont	2,092	140	2,232	0	6	238	49
Virginia	4,366	1,212	5,578	14	194	7,451	3,469
Washington	2,792	710	3,502	8	181	4,432	1,617
West Virginia	1,171	256	1,426	2	39	908	269
Wisconsin	1,838	611	2,449	23	187	5,127	2,455
Wyoming	123	27	149	0	3	175	55
U.S.	182,702	53,573	236,275	1,050	9,004	384,388	148,785

* Net foreclosures excludes investor-owned properties, nonresponsive borrowers and borrowers who failed to perform under an existing plan. Foreclosures estimated based on MBA's National Delinquency Survey and are grossed up to reflect the estimated market coverage of that survey.

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TABLE 10 - Estimated Subprime ARM Modifications and Foreclosures

	Repayment Plans	Loan Modifications	Total	Deed in Lieu	Short Sales	Foreclosures Started	Net Forclosures started*
Alabama	803	151	953	6	17	1,234	415
Alaska	340	18	358	0	1	109	25
Arizona	2,604	348	2,952	26	170	5,670	2,096
Arkansas	920	63	983	2	10	532	105
California	12,099	1,972	14,071	97	1,024	35,567	11,720
Colorado	1,769	433	2,202	15	308	3,744	1,067
Connecticut	1,352	172	1,524	5	66	1,982	707
Delaware	233	39	272	0	8	367	138
DC	284	9	293	0	9	261	65
Florida	8,339	840	9,179	47	352	20,562	5,744
Georgia	3,958	645	4,603	5	108	5,871	1,696
Hawaii	184	17	201	0	13	378	115
Idaho	513	63	576	3	23	482	146
Illinois	3,156	462	3,618	18	214	7,518	2,917
Indiana	2,327	344	2,672	15	99	3,732	1,013
Iowa	820	113	933	2	21	701	139
Kansas	484	66	550	1	30	657	211
Kentucky	795	133	928	4	60	1,359	424
Louisiana	994	147	1,141	0	32	1,163	390
Maine	564	47	611	2	20	438	97
Maryland	2,636	256	2,892	2	54	3,136	854
Massachusetts	1,929	282	2,211	2	116	3,608	1,133
Michigan	4,142	719	4,860	85	170	9,158	2,514
Minnesota	1,672	311	1,983	11	177	3,989	1,173
Mississippi	1,034	132	1,167	2	16	881	198
Missouri	1,857	233	2,089	8	69	3,127	993
Montana	104	26	130	0	3	111	37
Nebraska	776	76	852	1	13	447	99
Nevada	1,494	264	1,758	15	124	4,239	1,592
New Hampshire	458	97	555	3	14	655	150
New Jersey	1,788	191	1,979	11	94	3,664	1,222
New Mexico	790	62	851	1	20	370	73
New York	2,801	243	3,045	9	128	5,549	1,868
North Carolina	2,087	275	2,361	5	79	2,604	666
North Dakota	941	28	969	0	2	66	10
Ohio	3,270	616	3,887	56	249	6,520	1,684
Oklahoma	599	94	693	1	33	866	305
Oregon	700	96	796	0	57	1,054	324
Pennsylvania	2,511	347	2,858	6	72	2,959	1,003
Rhode Island	470	48	518	0	21	906	197
South Carolina	1,270	173	1,443	2	42	1,449	447
South Dakota	49	8	57	0	1	95	38
Tennessee	1,521	278	1,799	0	36	2,450	690
Texas	5,706	868	6,574	7	263	7,005	2,097
Utah	553	83	636	3	66	874	292
Vermont	892	10	902	0	2	127	21
Virginia	2,629	402	3,031	3	100	3,692	1,432
Washington	1,549	235	1,784	2	121	2,073	598
West Virginia	607	47	654	1	9	228	60
Wisconsin	1,073	151	1,224	12	101	2,140	700
Wyoming	76	9	85	0	3	84	23
U.S.	90,522	12,741	103,263	418	4,053	166,415	50,063

* Net foreclosures excludes investor-owned properties, nonresponsive borrowers and borrowers who failed to perform under an existing plan. Foreclosures estimated based on MBA's National Delinquency Survey and are grossed up to reflect the estimated market coverage of that survey.

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TABLE 11 - Estimated Subprime Fixed Modifications and Foreclosures

	Repayment Plans	Loan Modifications	Total	Deed in Lieu	Short Sales	Foreclosures Started	Net Forclosures started*
Alabama	377	275	653	0	9	644	168
Alaska	124	13	136	0	0	49	8
Arizona	487	193	680	2	27	806	247
Arkansas	240	107	347	0	9	287	87
California	1,889	1,022	2,910	18	362	3,628	1,164
Colorado	344	318	663	3	88	653	126
Connecticut	383	202	585	0	20	491	135
Delaware	93	33	126	0	4	128	26
DC	64	31	94	0	2	48	11
Florida	2,205	1,057	3,262	20	96	4,441	1,212
Georgia	1,319	752	2,072	4	57	1,810	392
Hawaii	81	20	101	0	9	110	45
Idaho	122	82	204	1	15	125	30
Illinois	824	467	1,292	5	59	1,914	636
Indiana	900	443	1,343	1	50	1,782	465
Iowa	327	256	583	3	19	323	79
Kansas	231	117	348	4	14	237	62
Kentucky	328	207	535	3	30	658	181
Louisiana	542	262	804	0	30	628	169
Maine	198	87	284	1	20	162	42
Maryland	619	180	799	2	26	789	197
Massachusetts	550	280	830	2	37	922	283
Michigan	934	980	1,915	9	46	2,373	527
Minnesota	299	252	551	3	40	592	149
Mississippi	396	288	684	0	25	519	115
Missouri	680	404	1,085	2	20	841	206
Montana	56	20	75	0	3	45	16
Nebraska	313	219	532	1	15	182	41
Nevada	179	194	372	5	20	418	149
New Hampshire	138	78	217	0	17	193	53
New Jersey	594	220	814	2	28	1,095	356
New Mexico	290	89	379	0	17	183	21
New York	2,053	573	2,626	5	70	2,874	780
North Carolina	1,016	369	1,385	4	56	1,367	314
North Dakota	384	147	530	0	1	26	3
Ohio	1,658	976	2,633	17	114	3,607	778
Oklahoma	406	225	630	2	21	550	56
Oregon	188	78	267	0	28	287	70
Pennsylvania	1,722	713	2,435	5	88	2,037	576
Rhode Island	128	48	175	0	14	202	55
South Carolina	800	357	1,157	0	27	1,008	261
South Dakota	7	7	14	0	2	35	10
Tennessee	764	407	1,171	0	43	1,200	262
Texas	3,088	1,411	4,499	5	136	3,702	961
Utah	127	53	180	0	20	201	61
Vermont	219	3	222	0	2	42	11
Virginia	741	398	1,139	0	33	861	228
Washington	394	187	581	0	35	583	176
West Virginia	145	103	248	1	18	186	37
Wisconsin	278	195	474	0	29	568	190
Wyoming	17	9	27	0	0	25	7
U.S.	30,261	15,407	45,668	130	1,954	46,438	12,232

* Net foreclosures excludes investor-owned properties, nonresponsive borrowers and borrowers who failed to perform under an existing plan. Foreclosures estimated based on MBA's National Delinquency Survey and are grossed up to reflect the estimated market coverage of that survey.

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TABLE 12 - Estimated Prime ARM Modifications and Foreclosures

	Repayment Plans	Loan Modifications	Total	Deed in Lieu	Short Sales	Foreclosures Started	Net Forclosures started*
Alabama	67	21	88	0	0	414	193
Alaska	196	6	202	0	0	61	26
Arizona	850	123	973	5	67	2,320	1,035
Arkansas	954	2	955	0	0	179	44
California	7,869	1,079	8,948	36	289	20,258	12,330
Colorado	646	135	781	6	104	2,167	1,087
Connecticut	577	45	622	2	10	495	267
Delaware	56	7	63	0	7	318	151
DC	160	11	171	0	5	128	63
Florida	3,978	417	4,395	61	119	10,620	4,920
Georgia	1,442	179	1,621	0	27	2,724	1,396
Hawaii	108	5	112	0	0	135	76
Idaho	166	28	194	0	5	179	90
Illinois	521	159	680	18	30	3,184	1,709
Indiana	1,208	56	1,264	3	12	1,505	805
Iowa	478	44	522	0	5	428	154
Kansas	143	20	163	2	7	273	143
Kentucky	228	25	252	0	9	443	234
Louisiana	240	30	271	0	3	454	212
Maine	470	5	475	0	2	130	51
Maryland	1,147	96	1,243	2	18	1,214	629
Massachusetts	411	114	524	5	66	1,501	988
Michigan	1,308	279	1,587	32	61	3,938	1,985
Minnesota	648	84	732	8	42	1,961	1,183
Mississippi	611	18	629	0	1	294	106
Missouri	364	39	403	3	17	894	500
Montana	26	5	31	2	0	119	57
Nebraska	539	16	555	1	1	162	28
Nevada	521	134	655	4	43	1,995	1,098
New Hampshire	138	22	160	0	9	237	126
New Jersey	506	113	619	0	34	1,885	1,215
New Mexico	765	8	774	0	2	110	24
New York	464	64	528	0	6	1,936	1,154
North Carolina	665	69	734	2	14	1,100	549
North Dakota	1,042	2	1,043	0	0	20	6
Ohio	985	150	1,136	7	69	2,562	1,403
Oklahoma	141	16	157	0	6	237	102
Oregon	309	42	351	0	5	367	200
Pennsylvania	910	81	991	2	6	1,023	518
Rhode Island	168	1	169	0	4	246	154
South Carolina	342	41	383	0	7	618	301
South Dakota	40	6	46	0	2	50	31
Tennessee	588	67	655	0	4	748	372
Texas	1,658	158	1,816	2	33	1,954	719
Utah	242	47	288	0	7	289	129
Vermont	736	3	739	0	0	20	4
Virginia	526	116	642	11	39	1,741	1,140
Washington	574	67	640	2	13	863	467
West Virginia	347	4	350	0	2	140	57
Wisconsin	185	45	231	8	28	947	657
Wyoming	17	2	19	0	0	25	15
U.S.	37,279	4,307	41,585	223	1,235	75,608	40,706

* Net foreclosures excludes investor-owned properties, nonresponsive borrowers and borrowers who failed to perform under an existing plan. Foreclosures estimated based on MBA's National Delinquency Survey and are grossed up to reflect the estimated market coverage of that survey.

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TABLE 13 - Estimated Prime Fixed Modifications and Foreclosures

	Repayment Plans	Loan Modifications	Total	Deed in Lieu	Short Sales	Foreclosures Started	Net Forclosures started*
Alabama	538	295	833	0	13	1,669	880
Alaska	73	130	203	0	0	110	33
Arizona	385	236	621	8	24	1,426	714
Arkansas	235	98	333	1	6	480	152
California	1,723	377	2,101	4	54	4,424	2,465
Colorado	441	414	855	5	125	2,099	1,013
Connecticut	334	153	486	0	16	692	345
Delaware	76	43	119	0	4	290	155
DC	53	50	103	0	1	64	21
Florida	1,986	963	2,949	27	88	8,527	3,884
Georgia	1,423	1,546	2,968	15	69	5,482	2,196
Hawaii	72	24	95	2	0	109	68
Idaho	71	115	185	0	8	287	104
Illinois	861	697	1,558	9	64	4,461	2,548
Indiana	655	719	1,374	4	78	4,936	2,157
Iowa	290	417	708	16	35	924	337
Kansas	154	205	358	3	22	827	367
Kentucky	326	294	620	3	32	1,394	635
Louisiana	449	486	935	3	25	1,147	468
Maine	228	74	303	0	6	262	104
Maryland	530	307	837	0	8	1,135	480
Massachusetts	363	241	604	5	22	1,436	769
Michigan	995	1,266	2,261	27	111	7,338	3,159
Minnesota	416	296	712	2	36	2,085	1,002
Mississippi	178	244	421	1	16	705	302
Missouri	490	397	887	2	26	2,048	1,010
Montana	116	61	176	0	6	91	55
Nebraska	326	367	693	1	13	473	126
Nevada	142	75	216	2	15	773	498
New Hampshire	58	138	196	1	8	304	129
New Jersey	538	459	997	0	31	2,597	1,800
New Mexico	416	246	662	0	7	344	51
New York	756	601	1,357	5	36	4,171	2,794
North Carolina	962	691	1,653	9	56	3,296	1,735
North Dakota	640	224	864	0	1	29	8
Ohio	1,308	1,392	2,700	60	175	8,017	4,076
Oklahoma	229	267	497	6	32	951	142
Oregon	184	132	316	0	3	430	125
Pennsylvania	852	861	1,714	10	38	3,663	1,832
Rhode Island	120	45	165	0	12	246	117
South Carolina	564	477	1,041	0	24	1,813	827
South Dakota	34	39	73	0	9	132	76
Tennessee	730	723	1,453	3	42	2,025	988
Texas	1,780	3,118	4,899	36	276	7,730	2,722
Utah	161	148	309	1	13	499	222
Vermont	245	124	369	0	1	49	13
Virginia	470	296	766	0	23	1,157	669
Washington	275	221	496	4	11	913	377
West Virginia	73	102	175	0	9	354	115
Wisconsin	302	219	521	2	30	1,472	908
Wyoming	12	6	19	0	0	42	10
U.S.	24,640	21,118	45,758	279	1,762	95,927	45,783

* Net foreclosures excludes investor-owned properties, nonresponsive borrowers and borrowers who failed to perform under an existing plan. Foreclosures estimated based on MBA's National Delinquency Survey and are grossed up to reflect the estimated market coverage of that survey.

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Ms. SÁNCHEZ. Thank you for your testimony, Mr. Kittle.

At this time I would invite Dr. Zandi to present his oral testimony.

TESTIMONY OF MARK M. ZANDI, Ph.D., CHIEF ECONOMIST AND COFOUNDER, MOODY'S ECONOMY.COM, WEST CHESTER, PA

Mr. ZANDI. Thank you, Mr. Chairwoman. Thank you for the opportunity today.

I just want to say that my views are my own. They are not those of the Moody's Corporation. I will make a half dozen points in my remarks.

First, the Nation's housing mortgage markets are suffering an unprecedented downturn. The last time I spoke before this Subcommittee, the market was bad. It has gotten measurably worse. Activity peaked 2.5 years ago, and since then home sales have fallen approximately 35 percent. Starts are down nearly 50 percent and house prices by 8 percent.

Two-thirds of the Nation's housing markets are experiencing substantial price declines, with double digit declines throughout Arizona, California, Florida, Nevada, the Northeast corridor and the industrial Midwest.

Second, residential mortgage loan defaults and foreclosures are surging, and without further significant policy changes, will continue to do so through the remainder of the decade. Falling housing values, resetting adjustable rate mortgages, tighter underwriting standards and weakening job markets are conspiring to create an unprecedented mortgage credit problem.

According to very accurate data based on consumer credit files, there were 450,000 first mortgage loans in default to the first step in the foreclosure process as of year-end 2007. This equates to some 1.8 million defaults at an annualized pace. Even mortgage loan modification efforts increase measurably in coming months, I expect almost three million defaults this year and next. At least two million homeowners will likely lose their homes.

Third, the severe housing downturn and surging foreclosures are weighing very heavily on the border economy, which may very well experience a recession this year. Regional economies, such as California, Florida, Nevada, much of the Midwest, parts of the Northeast, which together account for one-half of the Nation's GDP, are in my judgment already in or very near recession.

The unraveling of the housing mortgage markets continues to undermine the fragile global financial system, as Congressman Conyers points out. Estimates of the mortgage losses global investors will bear range as high as $500 billion. These losses that have been publicly recognized now total about $150 billion.

Losses on construction and land development loans made by the banking system to homebuilders are sure to increase measurably, and the credit problems in other consumer loans are rising rapidly, particularly in those parts of the country in recession due to the housing recession.

Fourth, while policymakers' efforts to date in responding to the mounting problems in the housing and mortgage markets and broader economy are helpful, they may very well prove inadequate. Since this past summer, the Federal Reserve has aggressively low-

ered rates. The Administration and Congress are quickly working toward a substantive fiscal stimulus package.

Policymakers are also working to shore up the housing and mortgage markets in several ways, the most notable including increasing the GSE's mortgage loan caps and the Treasury Department's effort through HOPE NOW to facilitate mortgage loan modifications and establishment of mortgage repayment plans for struggling homeowners.

Recent studies conducted by the MBA and Moody's Investors Service based on information provided by mortgage loan servicers through last fall indicate that hard-pressed homeowners are indeed receiving some increased relief. The Moody's study found that 3.5 percent of subprime ARM loans that reset in the first 8 months of this year had been modified. This is up from only 1 percent in an earlier survey conducted by Moody's.

Despite these improvements, given the still substantial impediments to loan modification efforts, they are unlikely to increase sufficiently to forestall an unprecedented number of foreclosures through the remainder of this decade with the consequent negative repercussions for the broader economy.

Tax, accounting and legal hurdles have been overcome, but large differences in the incentives of first and second mortgage lien holders and various investors in mortgage securities are proving to be very difficult.

While the total economic benefit of forestalling foreclosure is significant, these benefits do not accrue to all of the parties involved in determining whether to proceed with a loan modification. Moreover, given the overwhelming number of foreclosures, servicers are also having difficulty appropriately staffing the modification efforts.

It is also important to consider that for loan modifications to occur under the Treasury plan, many borrowers will have to produce more financial information than they did when they obtained the original loan. More than half of the subprime loans in 2006, for example, were stated income loans, for which borrowers were not required to produce a W-2 or tax return, and they will be reluctant to do so now.

There are thus a number of significant impediments to the effective implementation of the Treasury plan via HOPE NOW, suggesting that at best an estimated quarter million borrowers will actually benefit from loan modifications.

Thus, while HOPE NOW is a laudable effort, it should not forestall passage of legislation, H.R. 3609, to provide hard-pressed homeowners facing foreclosure more protection in a Chapter 13 bankruptcy. If HOPE NOW is successful in helping many borrowers, then these borrowers would not avail themselves of the opportunity to avoid foreclosure in Chapter 13 provided by this legislation. However, if HOPE NOW is not sufficiently successful, which may very well be the case, then this legislation will prove invaluable.

Thank you.

[The prepared statement of Mr. Zandi follows:]

PREPARED STATEMENT OF MARK M. ZANDI

Written Testimony of Mark Zandi
Chief Economist and Co-Founder
Moody's Economy.com
Before the House Subcommittee on Commercial and Administrative Law
Hearing on "The Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths"
Tuesday, January 29, 2008

Mr. Chairman and members of the Committee, my name is Mark Zandi; I am the Chief Economist and Co-founder of Moody's Economy.com.

Moody's Economy.com is an independent subsidiary of the Moody's Corporation. My remarks represent my personal views and do not represent those held or endorsed by Moody's. Moody's Economy.com provides economic and financial data and research to over 500 clients in 50 countries, including the largest commercial and investment banks, insurance companies, financial services firms, mutual funds, manufacturers, utilities, industrial and technology clients, and government at all levels.

I will make six points in my remarks. First, the nation's housing and mortgage markets are suffering an unprecedented downturn. Housing activity peaked two and half years ago, and since then home sales have fallen by approximately 35%, housing starts by nearly 50%, and house prices by 8%. Some two-thirds of the nation's housing markets are currently experiencing substantial price declines, with double-digit price declines occurring throughout Arizona, California, Florida, Nevada, the Northeast Corridor and the industrial Midwest. Further significant declines in housing construction and prices are likely through the end of the decade as a record amount of unsold housing inventory continues to mount given the ongoing turmoil in global financial markets and its impact

on the mortgage securities market and thus mortgage lenders and the recent weakening in the broader economy and job market. There is now a broad consensus that national house prices will fall by no less than 15% from their peak to their eventual trough.[1] Even this disconcerting outlook assumes that the broader economy will avoid a full-blown recession and that the Federal Reserve will continue to ease monetary policy.

Second, residential mortgage loan defaults and foreclosures are surging and without further significant policy changes will continue to do so through the remainder of the decade. Falling housing values, resetting adjustable mortgages for recent subprime and Alt-A borrowers, tighter underwriting standards, and the weakening job market are conspiring to create the current unprecedented mortgage credit problems. According to very accurate data based on consumer credit files, there were 450,000 first mortgage loans in default (the first step in the foreclosure process) as of year-end 2007.[2] This equates to some 1.8 million defaults at an annualized pace. Even if mortgage loan modification efforts increase measurably in coming months, I expect almost 3 million mortgage loan defaults this year and next. Of these, 2 million homeowners will go through the entire foreclosure process and ultimately lose their homes. The impact on these households, their communities, and the broader economy will be substantial. Foreclosure sales are very costly after accounting for their substantial transaction costs, and serve to significantly depress already reeling housing markets, as foreclosed properties are generally sold at deep discounts to prevailing market prices. In much less stressful times, these discounts are estimated to be between 20% and 30%.[3]

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[1] See "Aftershock: Housing in the Wake of the Mortgage Meltdown," Moody's Economy.com, December 2007.
[2] The source of this data is a 5% random sample of all the nation's consumer credit files maintained by credit bureau Equifax. The sample is drawn at the end of every month.
[3] See "The Value of Foreclosed Property," Anthony Pennigton-Cross, Federal Reserve Bank of St. Louis, September 2004. http://research.stlouisfed.org/wp/2004/2004-022.pdf. For an estimate of the impact of foreclosures on

Third, the severe housing downturn and surging foreclosures is weighing very heavily on the broader economy which may very well experience a recession in 2008 as a result. The stunning decline in housing activity and prices when combined with rising gasoline prices are crimping consumer spending, and the job market appears increasingly weak as it struggles with layoffs in housing-related industries. Regional economies such as California, Florida, Nevada, much of the Midwest, and parts of the Northeast, together accounting for close to one-half of the nation's GDP, are in my judgment already in or very near recession.

The unraveling of the housing and mortgage markets continues to undermine the fragile global financial system. Estimates of the mortgage losses global investors will eventually have to bear range as high as $500 billion.[4] The losses publicly recognized by financial institutions to date amount to no more than $150 billion. Losses on construction and land development loans made by the banking system to homebuilders are sure to increase measurably in coming quarters and the credit problems on other consumer loans are rising rapidly, particularly in those parts of the country in recession due to the housing downturn. These stresses are also exposing other weak spots in the financial system, including the monoline insurance industry and the credit default swap market. Given the opacity of the global financial system, it is unclear who are at most risk, and as such players in credit and equity markets remain on edge; unwilling to extend credit to each other. The availability of credit has been impaired and the cost of capital

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property values, see "There Goes the Neighborhood: The Effect of Single Family Mortgage Foreclosures on Property Values," Woodstock Institute, June 2005. http://www.woodstockinst.org/content/view/104/47/.

[4] See "Leveraged Losses: Why Mortgage Defaults Matter," Jan Hatzius, Goldman Sachs US Economic Research, November 15, 2007. "A Macro Look at Subprime Losses, ARMs and Convexity Hedging," Alec Crawford, RBS Greenwich Capital, November 2007.

has risen for nearly everyone, good credits and bad, and the negative economic repercussions are mounting.

The housing downturn is also undermining consumer spending. Even a modest pull-back by consumers will push the economy into recession, as such spending accounts for 70% of the nation's GDP. The odds of such a retrenchment are high given that the saving rate of the one-third of households who are homeowners and have borrowed against their homes in recent years is an estimated negative 10%. If this group, which also accounts for about one-third of all consumer spending, simply matches its spending to its income in the next couple of quarters, the negative impact on overall consumer spending will be substantial.

Fourth, while policymakers' efforts to date in response to the mounting problems in the housing and mortgage markets and broader economy are helpful, they may very well prove inadequate. Since this past summer, the Federal Reserve Board has aggressively lowered the federal funds rate target, and the administration and Congress are quickly working towards a substantive fiscal stimulus package. Policymakers are also working to shore up the housing and mortgage markets in several ways, most notable including increasing the GSEs' mortgage loan caps and the Treasury Department's effort through the Hope Now alliance to facilitate mortgage loan modifications and the establishment of mortgage repayment plans for struggling homeowners. Recent studies conducted by the Mortgage Bankers Association and Moody's Investors Service based on information provided by mortgage loan servicers through last fall indicate that hard-pressed

homeowners are receiving some increased relief.[6] The Moody's study found that 3.5% of subprime ARM loans that reset in the first eight months of 2008 had been modified. This is up from only 1% in an earlier survey conducted by Moody's.[7]

Despite these improvements, given the still substantial impediments to loan modification efforts they are unlikely to increase sufficiently to forestall an unprecedented number of foreclosures through the remainder of this decade with the consequent negative repercussions for the broader economy. Some tax, accounting and legal hurdles appear to have been overcome, but large differences in the incentives of first and second mortgage lien holders and the various investors in mortgage securities are proving to be daunting. While the total economic benefit of forestalling foreclosure is significant, these benefits do not accrue to all of the parties involved in determining whether to proceed with a loan modification. Given the overwhelming number of foreclosures, loan servicers are also having difficulty appropriately staffing their modification efforts. Servicers are being asked to also act like a mortgage originator, which many are ill-equipped to do. Moreover, loan servicers remain nervous about being sued by investors for not adhering to contracts that bar or limit loan modification. It is also important to consider that for loan modifications to occur under the Treasury plan, many borrowers will have to produce more financial information than they did when they obtained the original loan. More than half of subprime loans in 2006, for example, were so-called 'stated-income' loans, for which borrowers were not required to produce a W-2 or tax return to prove their income. They may be reluctant or unable to do so now.

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[6] See "An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and Other Loss Mitigation Activities in the Third Quarter of 2007," Mortgage Bankers Association, January 2008. http://www.mortgagebankers.org/files/News/InternalResource/59454_LoanModificationsSurvey.pdf and "U.S. Subprime Market Update: November 2007," Fricke and Drucker, December 17, 2007.

[7] See "Moody's Subprime Mortgage Servicer Survey on Loan Modifications," Moody's Investor Service, September 21, 2007. http://americansecuritization.com/uploadedFiles/Moodys_subprime_loanmod.pdf.

There are thus a number of significant impediments to the effective implementation of the Treasury plan via Hope Now, suggesting that at best an estimated 250,000 borrowers will actually benefit from loan modifications. Thus, while the Hope Now effort is laudable, it should not forestall passage of legislation such as HR 3609 to provide hard-pressed homeowners facing foreclosure more protection in a Chapter 13 bankruptcy. If Hope Now is successful in helping many borrowers, then these borrowers would not avail themselves of the opportunity to avoid foreclosure in Chapter 13 provided by this legislation. However, if Hope Now is not sufficiently successful, which may very well be the case, then this legislation will prove invaluable.

Fifth, this legislation, which would give bankruptcy judges the authority in a Chapter 13 to modify mortgages by treating them as secured only up to the market value of the property, will significantly reduce the number of foreclosures. An estimated over one-fourth of homeowners likely to lose their homes between now and the end of the decade, equal to an estimated 570,000 homeowners, would benefit from this legislation. This calculation is based on the number of homeowners who face a first payment reset through the end of the decade that would meet the means test required in a Chapter 13 and are still current on their mortgage loans. This would be very helpful in reducing the pressure on housing and mortgage markets and will measurably reduce the odds of recession next year. Note that in order to limit any potential abuses in this Chapter 13 modification process, Congress should provide firm guidelines to the bankruptcy courts, such as providing a formula for determining the term to maturity, the interest rate, and the property's market value.

Sixth, this legislation will not significantly raise the cost of mortgage credit, disrupt secondary markets, or lead to substantial abuses by borrowers. Given that the total cost of foreclosure to lenders is much greater than that associated with a Chapter 13 bankruptcy, there is no reason to believe that the cost of mortgage credit across all mortgage loan products should rise. Simply consider the substantial costs associated with navigating through fifty different state foreclosure processes in contrast to one well-defined bankruptcy proceeding. Indeed, the cost of mortgage credit to prime borrowers may decline. The cost of second mortgage loans, such as piggy-back seconds, could rise, as they are likely to suffer most in bankruptcy, but such lending has played a clear contributing role in the current credit problems. It is also important to note that the legislation currently being considered here today applies to existing first mortgage loans, and thus should have no bearing on interest rates on loans originated going forward.

There is also no evidence that secondary mortgage markets will be materially impacted after a period of adjustment, as other consumer loans which already have similar protection in Chapter 13 have well-functioning secondary markets. Moreover, the non-conforming residential mortgage securities market has already effectively shut down in the wake of the ongoing financial shock, and will only revive after there are major changes to the securitization process. The changes proposed in this legislation are immaterial by comparison.

It is very unlikely that abuses by mortgage borrowers will increase as a result of this legislation given that a workout in Chapter 13 is a very financially painful process. Indeed, the number of bankruptcy filings has remained surprisingly low since the late

2005 bankruptcy reform, likely reflecting the now much higher costs to borrowers in a Chapter 13 proceeding. Short-term housing investors or flippers, those who borrowed heavily looking to make a quick profit in the housing boom, would certainly not consider Chapter 13 as a viable solution to their financial problems.

The housing market downturn continues to intensify and mortgage foreclosures are surging. A self-reinforcing negative dynamic of mortgage foreclosures begetting house price declines begetting more foreclosures is underway in many neighborhoods across the country. The odds of a full-blown recession are very high. There is no more efficacious way to short-circuit this developing cycle and forestall a severe recession than passing this legislation.

Ms. SÁNCHEZ. Thank you, Dr. Zandi.

At this time I would invite Ms. Schwartz to give her testimony.

TESTIMONY OF FAITH SCHWARTZ, EXECUTIVE DIRECTOR, HOPE NOW ALLIANCE, WASHINGTON, DC

Ms. SCHWARTZ. Thank you, Chairman Sánchez and Ranking Member Cannon. I appreciate having the opportunity to testify today.

As you know, my name is Faith Schwartz. I am the executive director of the HOPE NOW Alliance. I want to tell you how the HOPE NOW Alliance is making real progress in an unprecedented joint industry and nonprofit national initiative to reach out to at-risk borrowers and find solutions to prevent foreclosures.

The HOPE NOW Alliance is a broad-based collaboration between credit and homeownership counselors, lenders, servicers, investors and housing trade organizations, where we have gotten together to achieve the real results and reaching more at-risk borrowers and providing positive solutions to avoid foreclosure.

HOPE NOW now includes 25 national loan servicers that comprise over 90 percent of the subprime market and a vast majority of the prime market. We have strong participation from respected nonprofits like NeighborWorks America and the Homeownership Preservation Foundation with its network of trained counselors, and we are adding and expanding that network of nonprofits.

While this is a voluntary effort, and it has certainly been created at the urging of the secretary of the treasury and Alphonso Jackson of HUD, I must say that once you are a member of HOPE NOW, you need to adhere to principles that are adopted by HOPE NOW. I will just mention a few of those in light of our time.

One of the early principles adopted was that everyone has to reach borrowers at risk in adjustable rate loans before the loans adjust at a minimum of 120 days prior to that adjustment. In addition to that, they must define the terms of the mortgage and all the options they would have if they cannot afford the adjustment.

Maybe the most notable principle that I think will have a dramatic effect on how loan servicers and consumer credit counselors and housing counselors communicate is every lender has agreed to create a 1-800 number, a fax and email that is assigned to just third-party housing counselors. This is a big step forward so that there is better communication and efficiency of how third parties can help borrowers at risk get right into the servicing shops.

Additionally, today we are releasing a set of numbers for all servicers direct for the consumers to have—all 800 numbers for all 25 servicers—and that is attached to our testimony, so that in all of your offices, you will have a way to reach all these loan servicers, if your constituents call.

A major challenge is that the borrowers who are in trouble are reluctant to call their servicers, and historically, one out of two loans that went to foreclosure were never in contact with their loans servicers. That statistic is changing. HOPE NOW is part of that, as are many of the other efforts that have been going on for some time to risk borrowers at risk.

HOPE NOW has an aggressive monthly direct mail outreach campaign to at-risk borrowers. It is a very targeted campaign for

those servicers who had had no contact with borrowers, despite numerous attempts to reach them. In November, HOPE NOW sent about 220,000 letters out to borrowers, and early response shows 16 percent of those borrowers responded.

Through January, we will see close to 700,000 letters sent to these most at-risk borrowers who otherwise would go to foreclosure, and we are encouraged by the early results of the most at-risk population.

For the November result, 21 percent of those who received a letter in November improved or maintained their delinquency status by making at least a payment. Forty-three percent of those who responded are in some sort of active loan mitigation or modification efforts. None of these borrowers had been in contact with their servicers prior to the outreach.

We are also actively providing nonprofit counseling to homeowners through our 888-995-HOPENOW hotline that is run by the Homeownership Preservation Foundation. This hotline has been in existence since 2003, and it has ramped up significantly this year, and you will hear some statistics of how they are manning the hotline and getting borrowers back into the servicing shops.

It is having a dramatic impact. Since the hotline's inception in 2003, 373,000 borrowers have called this hotline. In 2007 alone 245,000 calls have been made into the hotline, and those calls resulted in more than 83,000 homeowners being counseled in 2007.

Call volume in 2007 alone has increased tenfold in December from the beginning of 2007. By February 1st, we will have 400 housing counselors assigned to this hotline to help man the line and keep capacity and all of the activity in line to accommodate all the calls.

Last night President Bush cited HOPE NOW in the State of the Union address, and Secretary Paulson and HUD Secretary Jackson have urged homeowners in trouble to call the hotline. All of this attention does give more opportunity for borrowers to reach the servicers.

Ms. SÁNCHEZ. Ms. Schwartz, your time has expired.

Ms. SCHWARTZ. Oh, no. Okay.

Ms. SÁNCHEZ. Final thought, or——

Ms. SCHWARTZ. Well, I would like to speak to some of the metrics, and you will see on the board to my left we are going to measure all the metrics going forward. We now comprise the majority of the subprime market and the prime market at that point, so I think we are going to have some very good statistics to share with you and be transparent about all our results. We look forward to it.

[The prepared statement of Ms. Schwartz follows:]

PREPARED STATEMENT OF FAITH SCHWARTZ

TESTIMONY OF

FAITH SCHWARTZ

ON BEHALF OF

THE HOPE NOW ALLIANCE

U.S. House of Representatives Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

HEARING ON

Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths

Tuesday, January 29, 2008

Chairman Sanchez and Ranking Member Cannon, thank you for the opportunity to testify today on efforts to assist at-risk homeowners and prevent foreclosures. My name is Faith Schwartz and I am pleased to be here on behalf of the HOPE NOW Alliance to talk about the latest steps in this unprecedented joint industry and non-profit national initiative to reach out to at risk borrowers and find solutions to prevent foreclosures. I serve as Executive Director of HOPE NOW, and I am coordinating the efforts of all our industry and non-profit partners.

The HOPE NOW Alliance is broad-based collaboration between credit and homeownership counselors, lenders, investors, mortgage market participants, and trade associations. It was formed with the encouragement of the Department of the Treasury and HUD and builds on the efforts that Members of Congress, State Officials, and Federal Regulators have encouraged us to undertake. HOPE NOW is establishing a coordinated, national approach among servicers, investors, non-profit housing counselors, and industry participants to enhance our ability to reach out to borrowers who may have or expect to have difficulty making their mortgage payments and to offer them workable options to avoid foreclosure. The HOPE NOW Alliance is achieving real results in reaching more at-risk borrowers and in providing positive solutions that avoid foreclosure.

The members of the HOPE NOW Alliance recognize the urgency of this issue, and we are working to reach new milestones on a weekly basis. I will update you on these efforts which are intended to meet the goals we share with you and all Members of Congress – to help homeowners in difficulty and prevent foreclosures.

First, the Alliance is continuing to add members. As of January 29, we have 25 loan servicers in the Alliance who represent over 90 percent of the Subprime market and comprise a vast majority of the prime market. In addition, we have strong participation from respected non-

profits, led by NeighborWorks America and the Home Ownership Preservation Foundation, with its network of trained telephone counselors, and we are adding an expanding network of non-profits.

As one of the first steps to demonstrate industry commitment to results for HOPE NOW, on November 13, 2007 the loan servicers who are HOPE NOW Alliance members agreed to a Statement of Principles on reaching out and helping distressed homeowners remain in their homes. These principles were established to ensure that all borrowers can expect quality service and assistance when they contact their lender/servicer in the Alliance.

These principles are consistent with the calls by Members of Congress to the industry to expedite solutions for borrowers. The principles for HOPE NOW servicers are:

- HOPE NOW members agree to attempt to contact at-risk borrowers 120 days, at a minimum, prior to the initial ARM reset on all 2/28 and 3/27 ARM loan products.
- HOPE NOW members agree to inform borrowers of the potential increase in payment and terms of the loan, in an effort to determine if the borrower may face financial difficulty in keeping their mortgage current.
- HOPE NOW members agree to establish a single port of entry for all participating counselors to use by January 2008.
- HOPE NOW members agree to make available dedicated e-mail and fax connections to support counselor and consumer contacts by January 2008.

By establishing these principles, HOPE NOW members are improving the infrastructure needed to help more borrowers on a much larger scale. In addition to improving lender/servicer systems for working with counselors and borrowers, we must redouble efforts to reach out to at-risk borrowers.

You have heard it before, but it can't be emphasized too much: borrowers in trouble are reluctant to ask for help. It has been found that 50 percent of borrowers who go into foreclosure never contacted their servicer for help. We are working to drastically reduce that number and help as many troubled homeowners as possible avoid foreclosure.

In November, HOPE NOW servicer participants began a monthly direct mail outreach campaign to at-risk borrowers. This direct mail effort on the HOPE NOW letterhead is in addition to the thousands of letters and telephone contact efforts by individual servicers to their own customers.

In HOPE NOW's first direct mail effort in November, HOPE NOW members sent more than 215,000 letters to borrowers who are behind on their mortgage payments and who have not had contact with their servicer. The November letter provided a dedicated number to their servicer to call for help. As a result of these letters, more than 16% of borrowers responded by contacting their servicer, far more than the normal response rate of 2-3%. Borrowers who respond to the letters are getting help:

- 21% of those who received a letter in November improved or maintained their delinquency status by making at least one payment.
- 43% of those who responded to a letter by contacting their servicer engaged in active mitigation activity by the end of December and nearly half of these involved modifications.
- None of these borrowers had recently contacted their servicer prior to the HOPE NOW mailing.

In December, HOPE NOW repeated the direct mail campaign and this second letter, sent to 250,000 at-risk homeowners, contained not only the hotline of their servicer but also the 888-

995-HOPE Hotline, provided by the Homeownership Preservation Foundation. A third direct mail letter campaign began on January 22, and is sending several hundred thousand letters to at-risk borrowers who have not been in contact with their lender/servicer. We will report on the results of December and January letters as soon as that data is compiled.

The Homeowner's HOPE Hotline is a key component of the outreach and assistance effort for at-risk homeowners. The hotline directly connects the homeowners with a trained counselor at a HUD-certified non-profit counseling agency. This counseling service is completely free and is offered in English and Spanish. Those counselors have direct access to the lender/servicers through improved single points of entry that all HOPE NOW Alliance members have agreed to create.

We are asking Members of Congress and all concerned public officials to help publicize the HOPE NOW letter campaign and urge your constituents who receive a HOPE NOW letter to respond to it. More letters are being sent to at-risk homeowners right now and we will continue to gather date on the response rate of the mail campaign. The Homeowner's HOPE Hotline, 888-995-HOPE, is having a dramatic and positive impact for at-risk homeowners. The HOPE NOW Alliance will continue to expand the Hotline's capacity and promote it to reach more at-risk borrowers.

- Since the Homeowner's HOPE Hotline's inception in 2003, it has received over 373,674 calls which led to counseling for 146,197 homeowners.
- Calls are increasing monthly. In December, there were 93,794 calls to the Hotline that produced 15,462 counseling sessions.
- Through October 26, 2007, more than half of all homeowners counseled have been connected with their lender for assistance, and one quarter of all homeowners

counseled in the fourth quarter of 2007 were referred to their lender for a recommended workout.

- In 2007, the Homeowner's HOPE Hotline received over 245,000 calls.
- Those calls have led to more than 83,000 homeowners being counseled in 2007.
- That compares to 25,364 calls and 10,321 counseling sessions in all of 2006.
- Counseling sessions are rapidly increasing. Call volume has increased nearly 10-fold between first quarter 2007 and fourth quarter 2007.
- Lender/servicers are urging borrowers to call for counseling. Homeowners primarily hear about the Homeowner's HOPE hotline from their lender – up to 27% in fourth quarter.
- More homeowners with ARMS are calling – 48% of callers in fourth quarter of 2007, up from 34% in first quarter.

Publicity for the Homeowner's HOPE Hotline, 888-995-HOPE, continues to increase. We are proud that the HOPE hotline provides a resource for free, non-profit counseling to any homeowner, anywhere in the country. President Bush, Treasury Secretary Paulson, and HUD Secretary Jackson have mentioned the Homeowner's HOPE Hotline several times and they have urged homeowners in trouble to seek help. Members of Congress, including Financial Services Committee Chairman Frank and Senate Banking Committee Chairman Dodd have also highlighted the HOPE hotline. We are pleased that a number of Members of Congress have provided a link to the HOPE hotline on their websites.

Anytime the HOPE hotline phone number is mentioned by public officials or given out on television or radio, calls to the Hotline to increase dramatically. We welcome that support and are continuing to work to expand the counseling network for the hotline.

The Homeownership Preservation Foundation, the HOPE NOW Alliance member managing the telephone network, is continuing to add trained, experienced counselors to the program to handle the increasing call volume from concerned homeowners. Tremendous progress has been made in just the last few months. This number is available to homeowners 24 hours a day, 7 days a week. The Hotline now has six agencies with 385 counselors, up from 64 at the beginning of 2007. We expect to have 400 counselors available by February 1. The agencies providing counseling are: Auriton Solutions; CCCS Atlanta; CCCS San Francisco; Novadebt; Springboard and Money Management International. The Homeownership Preservation Foundation is continuing to work to add more agencies and counselors in the near future.

NeighborWorks America, a congressionally-chartered non-profit with a national network of more than 240 community-based organizations in 50 states, is a leader in the HOPE NOW Alliance, and is actively providing in-person counseling services to consumers today, as are many other counseling groups. NeighborWorks has also been the leader in working with the Ad Council on the national advertising campaign for the Homeowners' HOPE hotline. Television, radio and print advertisements for the HOPE hotline are part of the AD Council campaign.

In addition, HOPE NOW is working to add more non-profit agencies to the effort. In December, NeighborWorks and other HOPE NOW Alliance members met with HUD and other HUD counseling intermediaries to review ways to include additional grass roots counseling groups. We are working to broaden the HOPE NOW effort to ensure it is a model that works broadly for industry and non-profits to maximize the ability to reach troubled borrowers.

Reaching borrowers to work with them on a workable solution is the key to helping them stay in their homes. The solutions will vary with the circumstances of the borrower. Prudent

and responsible loan modifications, repayment plans and other types of workout options are solutions that can both help borrowers keep their homes and minimize losses to investors. The HOPE NOW Alliance is committed to pursuing all viable solutions to help people stay in their homes. The HUD Intermediaries are also part of the alliance in that they are dealing on the ground with homeowners on housing counseling. We continue to work toward a model that longer term is inclusive to all qualified third party credit counselors, ensuring strong efficient communication portals to loan servicers.

Results

HOPE NOW members understand that a crucial aspect of our efforts is to measure their effectiveness and success with homeowners at-risk. To that end, we are actively gathering data to measure results in assisting homeowners, and we are reporting it to Congress and the public as it becomes available.

Just recently, initial results were released about data on the efforts of lender/servicers to assist borrowers with loan modifications and other options to help them stay in their homes and avoid foreclosures. Loan modifications and repayment plans are two successful methods to allow homeowners in difficulty to get back on track with their mortgage and keep their homes.

On January 17, the Mortgage Bankers Association, a key member and leader of the HOPE NOW Alliance, released a study by Dr. Jay Brinkman, MBA's Vice President of Research and Economics. Dr. Brinkman's study covers actions lenders took to assist borrowers in the third quarter of 2007. MBA's study found that the industry initiated more than 235,000 loan modifications and repayment plans for borrowers with all types of loans in the third quarter of 2007. An estimated 54,000 loans were modified to assist borrowers and another 183,000

borrowers received repayment plans. For subprime ARM borrowers, MBA found that 12,750 received loan modifications and 90,500 received repayment plans in the third quarter of 2007. For borrowers with subprime fixed rate loans, the study found that 15,000 borrowers received loan modifications and 30,000 repayment plans. In total, MBA found that more than 148,000 subprime borrowers were helped in the third quarter alone.

In addition to the MBA study, the HOPE NOW Alliance has collected initial data from nine of the largest servicers who are part of the Alliance on their efforts to assist subprime borrowers. These servicers are handling 4.1 million loans, or approximately 58% of the outstanding subprime loans as of September, 2007. This data covers the second half of 2007 and like the MBA data, shows a dramatic increase in the number of subprime borrowers who are being assisted. Based on HOPE NOW's initial data from nine major servicers, we estimate that the industry helped 370,000 homeowners with subprime loans the second half of 2007. This includes 250,000 formal repayment plans and 120,000 modifications. Thirty nine percent of delinquent subprime borrowers were assisted with loan modifications and repayment plans in the second half of 2007.

In addition, the data shows that servicers are rapidly increasing their efforts to assist their subprime borrowers in trouble: mortgage servicers were modifying subprime loans during the fourth quarter at triple the rate of the third quarter.

HOPE NOW will update and expand on this data as we receive more data from the twenty five servicers that are now part of the Alliance and are collecting their data for HOPE NOW.

Accelerating Loan Modifications

As you know, loan modifications are the form of assistance to borrowers that have received much attention in the media. Loan modifications are a solution for borrowers who have an ability to repay a loan, and the desire to do so and keep their home, but may need some help in meeting this goal. Loan modifications are not the only solution – refinancing, forbearance, and repayment plans provide borrowers options that may be more appropriate than loan modifications.

HOPE NOW members recognize that an enhanced process for identifying borrowers who may benefit from a loan modification and establishing a process for advancing those is an essential part of expanding the efforts that are already underway.

The American Securitization Forum (ASF) is the organization that created a framework to allow servicers to more efficiently modify loans that are securitized in the secondary market. This effort has had the strong encouragement of the Department of the Treasury, HUD, Congress, the federal banking agencies and state officials.

The focus of the effort has been to identify categories of subprime hybrid ARM borrowers who can benefit from workout solutions that can help as many homeowners as possible remain in their homes. The key is to find solutions which help borrowers but do not violate the agreements with investors who now own the securities containing these loans.

The American Securitization Forum (ASF) has worked with servicers and ASF's investor members to develop a triage system to identify in advance of a reset solution for borrowers who would qualify for refinancing, loan modifications, and other workout options. Servicers are working to implement this framework. Servicers need a system to offer options to borrowers in a manner that does not violate the pooling and servicing agreements with investors.

Servicers need to be confident that investors will accept and support more far-reaching loan modification and other workout solutions, and will not engage in a series of law suits which can only slow down the effort to assist targeted borrowers.

The framework that the American Securitization Forum has established covers securitized subprime adjustable rate mortgage loans, the so-called 2/28's and 3/27's that were originated between January 1, 2005 and July 31 2007, with an initial interest rate reset between January 1, 2008 and July 31, 2010. In other words, the framework will cover loans that have just begun to adjust. We believe that the ASF-established framework will help increase positive outcomes on loan modifications and repayment plans that will add to the strong initial results we have reported on today.

The ASF framework will help provide solutions for homeowners with these subprime hybrid ARMs who fall into three categories.

Refinancing:

The first category or segment of borrowers are those who are current, likely to remain current even after reset, or likely to be able to refinance into available mortgage products, including FHA, FHA Secure or industry products. Generally, the servicer will determine whether loans may be eligible for refinancing into various available products based on readily available data such as LTV, loan amount, FICO, and payment history. The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties whenever feasible. HOPE NOW will continue to work with the alliance to ensure all servicers have access to products and programs available largely in the market to refinance eligible borrowers.

Loan Modifications:

This second category or segment of borrowers includes those with good payment records but who will not qualify for refinancing; these borrowers will be targeted for streamlined loan modifications. These are borrowers who are unlikely to be able to refinance into any available product. These borrowers will be eligible for a fast track loan modification if the loan is secured as a primary residence and meets additional criteria regarding their upcoming reset and their ability to pay at the reset amount, using evaluating factors such as a comparison of their original and current FICO score and a Loan to Value test. Borrowers in this category will be offered a loan modification for 5 years under which the interest rate will be kept at the existing rate of the loan.

This fast track option does not in any way preclude a servicer from conducting a more individual in-depth review, analysis, and unique modification for a borrower to determine if a longer term modification would be appropriate.

The fast track framework allows the servicer to make these decisions:

- The borrower is able to pay under the loan modification based on his current payment history prior to the reset date.
- The borrower is willing to pay under the loan modification by agreeing to it after being contacted.
- The borrower is unable to pay (and default is reasonably foreseeable) after the upcoming reset under the original loan terms, based on the size of the payment increase that would otherwise apply, and based on current income if the borrower did not pass the FICO improvement test.
- The modification maximizes the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are not available and the borrower is able and willing to pay under the modified terms.

Loss Mitigation:

This third category includes loans where the borrower is not current and is not able to refinance into any available product. These are borrowers who are significantly behind in their payments and their situations need to be evaluated individually. It is especially important for us to reach this group of borrowers through efforts such as the HOPE NOW direct mail campaign and through the national advertising campaign for the Homeowner's HOPE hotline. For loans in this category, the servicer will determine the appropriate workout and loss mitigation approach on a loan-by-loan basis. Referrals from counselors if the borrowers contact the Homeowners' HOPE hotline will also be important. The approaches for these borrowers may include loan modification (including rate reduction and/or principal forgiveness), forbearance, short sale, short payoff, or foreclosure. Because these borrowers are already behind in their payments, and may face challenges such as loss of income or other issues, they require a more intensive analysis, including current debt and income analysis, to determine the appropriate loss mitigation approach. It is equally important to note that HOPE NOW is working toward helping all borrowers at risk, not just those subprime ARM borrowers eligible for fast track refinance or modifications. For homeowners in this status, servicers will need further communication and understanding of the borrowers' situation. We have had great assistance from housing counselors already with borrowers in this category and we continue to make contact with at risk borrowers our highest priority.

It is important to note that the framework established by ASF for a streamlined, scaleable solution for current borrowers facing a reset will also allow for servicers to give more detailed attention to at risk, hard to reach, delinquent borrowers. Servicers will be able to work closely with credit counselors and or homeowners to ensure all options are explored to avoid

foreclosures. The scaleable outreach, streamlined modification effort in no way precludes on going workout solutions for the highest risk, delinquent borrowers

We are committed to an aggressive system of contacting borrowers and finding solutions for them. As I stated, HOPE NOW is tracking and measuring outcomes. In addition to the data we have reported on today, we will measure trends in delinquencies and resolution outcomes, e.g. reinstatement, workout (repayment plans, modifications, short sales, deed in lieu, partial claims) and foreclosure. We want to provide consistent and informative data reports based on common definitions and to provide information that provides insights into the nature and extent of the current mortgage crisis and helps in the development of workable solutions that avoids foreclosure whenever possible.

Importantly, the measures we are developing will be available for both the national and state aggregate levels.

As our data collection initiatives mature and the data is validated, we will provide you state-level information. As I noted, our alliance is growing weekly. Our participating servicers have been engaged in developing standard definitions for key loss mitigation data. We are still in a fairly early stage of collecting and validating data. This is an enormous undertaking which will take time to develop fully. We are confident, however, that we will be able to deliver systematic information at the national and state level that will help measure what servicers are doing to resolve difficult situations and to assist homeowners.

Conclusion

The HOPE NOW Alliance and those working with it are committed to enhanced and on-going efforts to contact at-risk homeowners and to offer workable solutions. Our top priority is to keep people in their homes and to avoid foreclosures whenever possible. As I reported

today, our initial results indicate that 370,000 homeowners were assisted in the second half of 2007. We are working to help many more at-risk homeowners.

We need the active involvement of all Members of Congress to alert constituents that help is available when they contact either their lender/servicers or a non-profit counselor through the Homeowner's HOPE Hotline.

The HOPE NOW Alliance is a serious and committed effort that will continue as long as necessary until problems in the housing and mortgage markets abate. My testimony today includes initial, but real and significant results on the number of homeowners who have been helped. We will provide updates on our progress to Congress and other concerned policymakers in the coming weeks which we believe will continue to demonstrate the efforts being made to assist homeowners in distress and to prevent foreclosures whenever possible.

Thank you for inviting the HOPE NOW Alliance to testify today.

Ms. SÁNCHEZ. Thank you.

As you will notice, we have had a series of buzzers go off that has signaled to us we have votes pending across the street. Since we have about 6 minutes to get across the street to vote, we are going to stand in recess. When we return from votes, we will hear the testimony of Mr. Dodds and Mr. Carr. So we are in recess. Thank you.

[Recess.]

Mr. JOHNSON. [Presiding.] Okay. This hearing is now called back into order.

And before we get started, I would like to, by way of unanimous consent, include the following documents into the record. Number one, a statement by the Honorable John Conyers, the Chair of the full Committee. It is dated January 29th. Also I want to include an article out of the *Detroit Free Press* dated January 29, 2008, entitled, "Will the State Stay Third in Foreclosure Rate?" referring to the State of Michigan.

Also, a statement of the National Association of Consumer Bankruptcy attorneys dated January 29, 2008, entitled, "Hearing the Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths." Also a study by Professors Adam J. Leviten and Joshua Goodman from Georgetown University Law Center dated January 28, 2008, entitled, "The Effect of Bankruptcy Stripdown on Mortgage Interest Rates."

Also to be included in the record would be a chart that is from AlixPartners, page 13, that depicts an overview of the subprime lending industry. And last, but not least, a statement from the Center for Responsible Lending, a rebuttal to the ABA bipartisan House Resolution 3609. It is dated January 28, 2008.

And that having been accomplished, we will now resume our testimony. Now, we will go Mr. John Dodds.

Mr. Dodds?

TESTIMONY OF JOHN DODDS, DIRECTOR, PHILADELPHIA UNEMPLOYMENT PROJECT, PHILADELPHIA, PA

Mr. DODDS. Thank you for having me today. I am John Dodds from the Philadelphia Unemployment Project. Our organization has spent many, many years working on protect homes of homeowners. We work directly with people facing foreclosure. We have worked in Pennsylvania. We have the only state foreclosure prevention program in the country, which has helped over 40,000 families save their homes.

Recently, I was in Cleveland, Ohio, looking at doing a tour there. I can tell you it was a very appalling situation, the number of abandoned properties everywhere we looked, properties being stripped of aluminum siding off the walls sold for scrap—very, very depressing.

And there we have in front on the subprime problem. Their foreclosures have already started. Properties are going for $14,000 a year, if people will buy them in those neighborhoods. And people can't even sell a house for that amount.

We are trying to stay out ahead of that in Philadelphia. We are doing a little better there. I am thinking the whole country would

want to stay ahead of that. We don't want to see these subprime loans turn into foreclosures and abandoned property.

We have two million subprime loans that are going to reset in the next 18 months, and the question is how do we keep these loans performing? I think that is what everybody wants—to see these loans perform—and we think that they ought to be modified, that the terms are not affordable for people. Very often people were sold a bill of goods, or maybe they over promised or whatever, but it is bad for the entire economy for these loans to go bad and to foreclose with the kind of numbers we could see.

So also, in Philadelphia we have many, many neighborhoods were over half of the loans are subprime. Now, we right now do not have too much abandonment. If these loans go through in the next 18 months, we could see many, many abandoned properties, which will deteriorate the property values of the homeowners that haven't lost their homes, too. Abandoned properties obviously bring down values quickly.

So affordable loan modifications is what we think needs to happen, but it is not going to happen to scale, and I want to tell you why. We work with homeowners every day. One thing is that mortgage companies have had a long history of basically being collectors. They collect bills. If you don't pay, somebody calls you and says, "Pay, or else."

Now, we are trying to switch to a different mentality. We are going to do loss mitigation. We are going to work this out. We have found that this is very difficult. We have homeowners that are not being offered affordable deals at all. In fact, they are being offered deals—double payments, things like that, when people can't afford.

I have with me today Janice Freeman, who was with Wells Fargo. She got behind in her mortgage. No deal was offered. She ended up in a bankruptcy.

Ms. Freeman, do you want to stand up?

She ended up in a Chapter 13 bankruptcy, because she didn't know what else to do. She was told, "Forget it. You have got to pay everything, or else." She got into bankruptcy.

Bankruptcy doesn't work right now. This is why this legislation is important. She paid her lawyer over $2,400 over a period of time to get into bankruptcy. Her payment was raised from $1,147. She had to pay another $400 a month, because she couldn't pay her mortgage, so they put her in a plan in which she would pay the mortgage plus $400 plus the lawyer.

She ended up three different times she got behind. The lawyer had her file again, $350 each time. Now, she only owed $3,500 when she got into this situation. Now her bankruptcy is dismissed.

We are working with her right now to get a loan modification. That is what she should have had—terms that she can afford. This is what this legislation would do, which would put people in a situation where bankruptcy would actually change the terms so they can afford it. Bankruptcy right now just makes you pay your current mortgage plus, which people can't do.

The other thing is people get put into payment plans, payment plans that they can't afford at all. They should be getting—once again, I think what HOPE NOW is hoping for, and many of us are hoping for is—loan modifications that make sense.

But Janice Lee, who is also here, was offered double payments. She finally got herself into—after a very aggressive young woman—she finally got a decent payment plan. It is good for 6 months. At the end of 6 months, she has got a $10,000 balloon payment. There is no way she can make that payment.

So what we think has to happen is loan modifications have to happen in large scale. We just don't think it is possible in the terms that we have. In the next 18 months, the lending companies are not going to be in a position to do these. These are time consuming. They have to collect all kinds of data—pay stubs, bills, and so forth.

We had a nice time with Countrywide, where we are working with the top executives. They offered us a pipeline to get our things done quickly. We sent down about a dozen loans—Countrywide Mortgage delinquent mortgages—and a month letter people are starting to get sheriff sale notices. They are starting to get foreclosure notices.

We called Countrywide. We have a special hotline for advocates. We are advocates. We called, and they said, "You know what? None of your papers have gotten through imaging yet." They are all in imaging, meaning they hadn't been copied, so nobody had even looked at one of the documents a month later.

I think that that is what is going to happen all over this country, as this tidal wave of foreclosures comes through. And even to the good-hearted lenders that are trying to work this out, there is going to be a volume problem, and I think we are going to see that. And we are seeing that, and that is what we are seeing, that the people aren't getting these done.

Then where are they going to go? They are going to lose their homes. Or there will be a safety valve. We think that this legislation will be a safety valve. 3609 will be a safety valve, so at that point, when they are in foreclosure, that they can go file a bankruptcy, and then the judge will be able to modify the terms to make them affordable.

One thing that——

Mr. JOHNSON. All right, Mr. Dodds, your time has expired. Very sorry.

Mr. DODDS. Okay. Well, thank you. So we think it is a problem, and this is a solution, not the only solution, to a real world problem that is not going to get fixed by just talk.

[The prepared statement of Mr. Dodds follows:]

PREPARED STATEMENT OF JOHN DODDS

Statement of John Dodds,
Director, Philadelphia Unemployment Project

U.S. HOUSE COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

"THE GROWING MORTGAGE FORECLOSURE CRISIS: IDENTIFYING SOLUTIONS AND DISPELLING MYTHS"

January 29, 2008

My name is John Dodds and I am Director of the Philadelphia Unemployment Project, a non profit advocacy organization in Philadelphia, Pennsylvania that deals with issues of poor and unemployed workers and their families. We have spent a great deal of time and effort on the issue of foreclosure prevention since the early 1980s. We are currently deeply involved in working with homeowners caught up in the sub prime mortgage crisis.

As I understand it, the purpose of this hearing is not to assess blame for the crisis, but rather to figure out how to prevent the excesses of the past several years from causing further financial devastation to homeowners and families, communities, investors, banks, mortgage companies and the U.S. and world economies.

I have with me today photographs that were taken during a December tour of Cleveland, Ohio in which we participated along with top officials of Countrywide Financial Corporation. Cleveland is ahead of Philadelphia and most of the nation in terms of foreclosures resulting from subprime lending. The condition of many neighborhoods is nothing short of appalling. Boarded up and deteriorating homes are everywhere. The aluminum siding is being stripped from the walls of the homes to be sold for scrap. Most of the homes can not be salvaged, only demolished, but there is no money to do even that. Houses in these neighborhoods are selling for $14,000 if anyone wants to buy a home in such a devastated community. We hope to keep this catastrophe from spreading to my city of Philadelphia and to other communities all over the country. We are already seeing homes getting newly boarded up in Philadelphia and on a larger scale we are seeing the entire world economy shaking and maybe getting ready to fall into a severe recession due to the subprime fiasco. This is a crisis and we need to address it and address it quickly.

We know that the current housing crisis is being driven by the resets on subprime loans that put the cost of the monthly payment beyond the reach of homeowners. Unfortunately, we know that the problem is only going to get worse as up to two million subprime loans are scheduled to reset within the next 18 months. The question we need to ask is how to prevent these reset and subprime loans from ending up in foreclosure and how to do it on a scale that is adequate for the size of the problem. An important tool should be modifying loans to make them affordable for the homeowners.

We are told that the investors and servicers do not want to foreclose on these properties. But still we see only a limited numbers of loans being modified as the clock ticks toward disaster. We need to modify these loans to make them affordable for homeowners, and in such a way that investors can avoid the losses that come with foreclosure and receive a steady stream of income from a performing loan. We need loan modifications based on what a family can actually pay, not a fanciful number that generated revenues for brokers, mortgage companies and securitizes, but never was going to work in the real world.

The problem is that modifying a loan takes a good bit of time and effort, including verification of the borrower's income, expenses, employment, etc. With the volume of bad loans on the books, we won't have the time to do the loan mods that need to be done to prevent the looming collapse. After we met with the Countrywide officials in early December, they agreed to give us special staff to help us with work outs for our members

and clients. We sent a dozen cases to them and waited for their response. As a month went by we had people having foreclosure actions filed and sheriff sales approaching. We called our Countrywide contacts, who are meant to be the conduits for the advocates to get prompt service. They told us that after a month none of our paperwork had even made it out of the imaging department. No one had even looked at one bit of information. Last Friday we were happy to get a response from Countrywide on our cases. They had decided to offer some loan modifications. This is a good thing and we appreciate it, but we were supposed to be in the priority line and even our cases got back logged. With over 2 million loans in the pipe line, we think that this is going to be an ongoing problem for homeowners and lenders everywhere. Most homeowners won't be on what passes for the fast track. How will they get workable deals before the Sheriff's Sale takes their homes from them?

Also, there is a disconnect between the rhetoric and the probably real concern of the mortgage industry about doing loan modifications and the reality of what is happening in the collections departments and loss mitigation departments of our servicers. We still see collections people strong arming scared homeowners into payment plans that they cannot begin to afford or telling them there is nothing they can do but lose the home due to their financial situation. Families are very often not told of loss mitigation options. In some cases when the borrower knows to ask for loss mitigation, the homeowner has the loss mitigation department slowly considering them for some kind of a work out, while at the same time, the collections department is demanding unaffordable payment plans. Too often in the same company the left hand doesn't know what the right hand is doing. This could help explain the recent Mortgage Bankers Association study that found that homeowners were twice as likely to lose their homes as have a workout done that would allow them to remain in their property. There is still a hard line bill collector mentality and culture in mortgage companies. It needs to change at once and it's unlikely to happen before far too many homes and loans are lost.

What we are hoping to accomplish in Philadelphia is to work out agreements with large lenders to let our fairly extensive non-profit housing counseling network collect the documents needed and decide what an affordable loan modification would be, based on income and expenses and then get the lenders to do stream line loan modifications for our clients. This could prevent mass foreclosures and guarantee investors of performing loans, before thousands go under. We don't want to have the Cleveland experience recreated in Philly and neither will anyone else want this in their communities.

But what about the Miller/Sanchez bill, as amended with a bipartisan compromise crafted by Chairman Conyers and Rep. Chabot? We think it will be a critically important tool for reducing the numbers of foreclosures of subprime loans. Ideally, lenders would fix all of the loans, but that is not the real world. We can all hope that they will step up the pace, but many, many families will fall through the cracks if our only plan is voluntary action by loan servicers.

A big problem with such a plan is that the servicers will have real problems even reaching the delinquent homeowners. When people are in trouble and don't know how to

pay their bills, very often they try to avoid the topic. They won't open mail or talk to collectors and they try to duck the problem. They think they know what's in that letter from the mortgage company and it is nothing good. So it stays in the envelope.

But I can tell you what the word on the street is if you are in trouble with your mortgage. The conventional wisdom in lower income communities is that you can always file bankruptcy to save your home. Unfortunately, that isn't usually true in the current crisis and wasn't even true for most people before the recent changes in bankruptcy law. Many people stopped a Sheriff's Sale with a Chapter 13, but the numbers who could pay the trustee, the attorney, the mortgage company's attorney, the back mortgage payment and the current mortgage over a long period were not that great. But people still file Chapter 13s in great numbers, often solicited by Chapter 13 attorneys trying to make a living.

I mention this because, if we change bankruptcy laws to actually make Chapter 13 an effective way to prevent a foreclosure and to make the loan one that the homeowner can afford, we have a dedicated work force who will make sure people find out about the changes, the attorneys who will represent the borrowers. Families who can't work out a reasonable payment plan with the servicer will still have a way to get the courts to step in and make sure that reasonable loans are provided in place of the high cost mortgages that so many people ended up with.

HR 3609 calls for temporary bankruptcy reform to get us through this crisis. It will only cover loans made between January 1, 2000 and the date of enactment. It will take care of fears that servicers have of law suits from investors who don't want loans modified and it will catch people who are not being aided by voluntary lender actions. It will be good for families, communities and their property values, investors and the American economy. We can't just sit back and hope that voluntary action by loan servicers will solve this crisis. The consequences of failure are too grim. Let's use as many tools as we can to get us out of this sub-prime mess. We all need a successful resolution to the dilemma we find ourselves in today. We urge immediate positive action on HR 3609.

Mr. JOHNSON. Thank you.
Mr. DODDS. Thank you.
Mr. JOHNSON. All right.
Mr. Carr?

TESTIMONY OF JAMES H. CARR, CHIEF OPERATING OFFICER, NATIONAL COMMUNITY REINVESTMENT CORPORATION, WASHINGTON, DC

Mr. CARR. Good afternoon.
Mr. JOHNSON. Good afternoon.
Mr. CARR. On behalf of the National Community Reinvestment Coalition, I am honored to participate in the hearing today.

Regional economic downturns, speculation on skyrocketing home values, and widespread and unfair and deceptive mortgage lending practices have combined to create the perfect foreclosure storm in America. Common to all three of these contributing factors is the reality that effective regulation of the markets would have greatly limited the foreclosure damage we are currently experiencing.

Moreover, unfair and deceptive practices contributed to the other foreclosure related stimuli. By offering products, for example, based on inadequate underwriting, and often combined with fraudulent or otherwise inappropriate appraisals, these loans gave the illusion of affordability to millions of families and also in the process helped to create the housing bubble.

It would be difficult to overstate the significance of the collapse of the subprime market and its attendant foreclosure crisis. The damage goes far beyond its direct effect on the families who are losing their homes. The negative fallout is impacting heavily the communities in which those foreclosures are heavily concentrated, the national economy and international markets.

As a result, homeowners across the country are now paying for the extraordinary failure of regulation of the subprime market, regardless of whether they had anything to do with a subprime loan. Both the Administration and the Federal Reserve Board have concluded that unfair and deceptive practices contributed to the collapse of the subprime market.

The Federal Reserve has proposed rule changes pertaining to subprime mortgage lending that address almost every aspect of the lending process. It is a clear statement of the extent to which lending abuses had become prevalent. Those rules address issues ranging from the ability to repay loans, verification of income, marketing practices, prepayment penalties, servicing abuses, excessive broker fees and many other issues.

Their proposed rules are a good start. More needs to be done to address this issue to purge it fully from the market. Moreover, legislation is needed to forcibly address the housing related institutions that are not covered by the Federal Reserve.

The foreclosure crisis threatens the long-term stability of the housing markets and the U.S. economy. Failure to stabilize the housing markets would compound and make worse an economic downturn, and a severe economic downturn would presuppose more families to foreclosure.

Further, the deterioration in home prices threatens the most significant asset held by the typical American household. As a result,

at a time when working families are worried about stagnant wages, loss of employment benefits, rising health care and energy costs, and ballooning consumer debt, failure to mitigate further the deterioration of home equity could create greater anxiety among the American public and a further loss of consumer confidence that of course would be very harmful for the economy.

There are several initiatives that have been discussed already—FHA Secure and the HOPE NOW hotline. These initiatives are essential, critical to addressing this problem, but for reasons for which I would be pleased to discuss in Q&A, these initiatives by themselves are not substantial enough. Basically, it is the scale of the problem and the types of solutions that are being offered.

As a result, the bankruptcy bill that is being discussed today, H.R. 3609, would be an important added feature to help homeowner who are immediately at risk of losing their homes. Importantly, how they got there helps to justify the change in legislation, and that is the reality that many of those loans are predicated on unfair and deceptive practices. So as a result, unwinding them is not unfair to the lending institutions that put those consumers at jeopardy in the first instance.

In the interest of time, I will conclude by saying as Harvard University professor Elizabeth Warren pointed out, and she is the person who coined the term "exploding mortgages," families have had better consumer protection buying a toaster or microwave oven than purchasing a home.

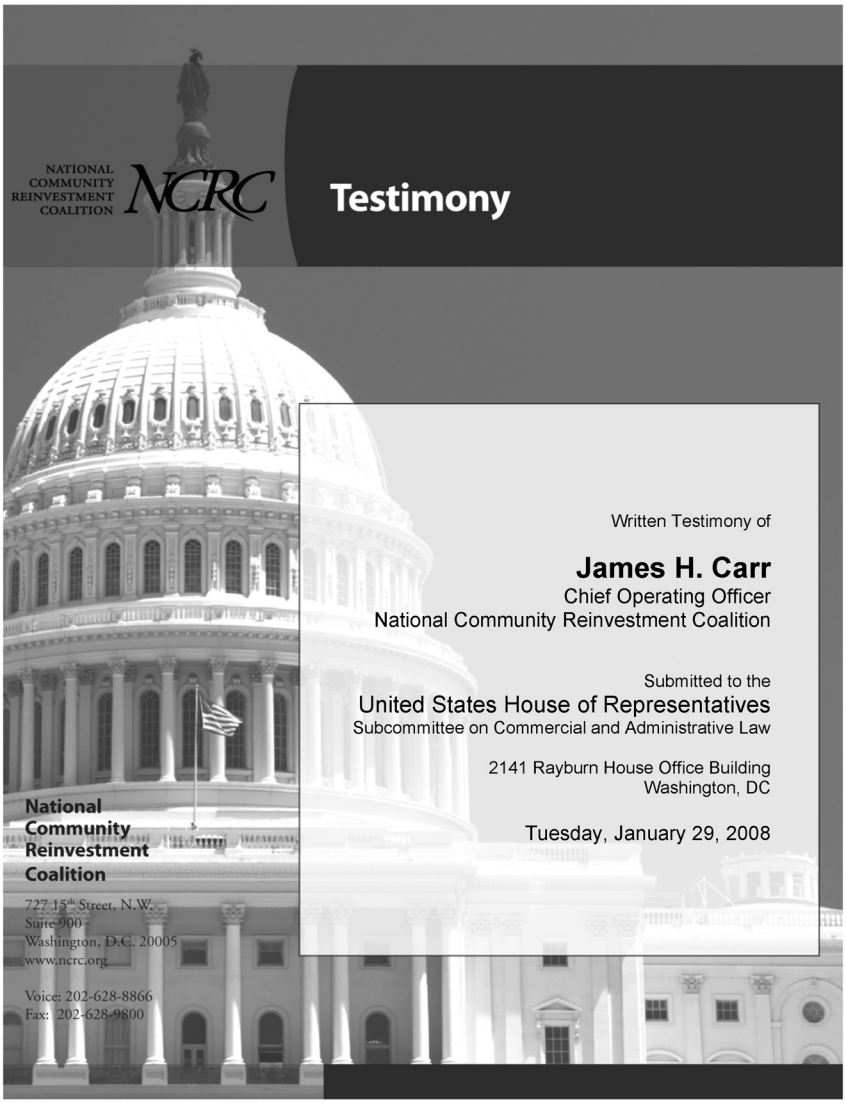
The time has come to help consumers who have been financially damaged by failed regulatory policy in the mortgage arena. That fix will not be cost free. There will be pain, and it needs to be shared.

Equally, the time has come to eliminate predatory lending practices from the housing markets once and for all. The American public deserves better.

Thank you.

[The prepared statement of Mr. Carr follows:]

PREPARED STATEMENT OF JAMES H. CARR



Responding to the Foreclosure Crisis*

James H. Carr
Chief Operating Officer
National Community Reinvestment Coalition

> *"It is impossible to buy a toaster that has a one-in-five chance of bursting into flames and burning down your house. But it is possible to refinance your home with a mortgage that has a one-in-five chance of putting the family out on the street…."*
>
> Elizabeth Warren
> Leo Gottlieb Professor of Law
> Harvard University

Introduction

Regional economic downturns, speculation on skyrocketing home prices and rampant unfair and deceptive mortgage lending practices have combined to create the perfect foreclosure storm in America. According to the FDIC, there is roughly $1.3 trillion of outstanding subprime mortgage debt (Poirer, 2007). In 2006 alone, more than $600 billion of subprime mortgages were originated (Inside Mortgage Finance, 2006). RealtyTrac data shows roughly 450,000 homes experienced foreclosure in the third quarter of 2007, up a full 100 percent from the same period one year ago (Yoon, 2007). And, although foreclosures are most heavily concentrated in 12 to 20 states, foreclosures are up in 45 of 50 states. Federal Reserve Board Chairman Ben Bernanke reported that 21 percent of subprime adjustable-rate mortgages were ninety-days delinquent or more as of January 2008 and according to the Center for Responsible Lending (Center for Responsible Lending) fully one in five subprime loans are expected to fail (Bernanke, 2008; Center for Responsible Lending, 2007). That rate of foreclosure is estimated to translate into more than two million families losing their homes to foreclosure over the next year to 18 months (Center for Responsible Lending, 2007). Estimates of the full economic costs of the foreclosure crisis vary greatly. The projections share, however, a common theme: the prospect of significant financial costs that extent beyond the housing market.

Collapse of the Subprime Market

In November 2007, the U.S. House of Representatives voted overwhelmingly to approve a comprehensive anti-predatory lending bill. One of the key provisions of that legislation bars financial institutions from making mortgage loans to consumers who cannot repay those loans (HR 3915). This provision serves as a metaphor for the dysfunctional practices that have come to define the subprime market over the past decade. Studies and reports on subprime loans reveal problems in almost every aspect of the subprime lending process (Carr et al., 2001; Carr, 2006; National Community Reinvestment Coalition, 2002, 2005, 2007; Center for Responsible Lending, 2007; Schloemer et al., 2006; Engel & McCoy, 2002). In fact, nearly a decade ago, the North Carolina legislature passed a law to prohibit predatory lending (North Carolina, 1999). Inappropriate loan products, inadequate underwriting, bloated appraisals, abusive prepayment penalties, excessive broker fees, steering borrowers to high cost products, and servicing abuses, have been widely reported (Calem et al., 2004; Eggert, 2004; Engel & McCoy, 2004; Farris & Richardson, 2004; Lax et al., 2004; Quercia et al., 2004; Renuart, 2004; Seifert, 2004; White,

* An edited version of this paper has been accepted for publication in *Housing Policy Debate*, Volume 18, Issue 4.

2004; Wyly et al., 2004). Funding of subprime loans has also played a major role in the crisis. The rating of securities as investment grade products that were backed by loans that might aptly be described as subprime mortgage junk bonds fueled the funding pipeline that enabled the exponential growth of the subprime market. Without the extraordinary access to financing provided by securitization, the growth of the subprime market would have been greatly limited and the financial damage to homeowners and the economy significantly reduced.

Prior to securitization, banks were meticulous about making sure that borrowers could repay their loans. That was because banks held loans in their portfolio. In short, their own money, and that of their customers, was at risk. But with securitization, this self-regulatory incentive mechanism was lost.[1] And, despite this transformation of the markets, federal regulation of the mortgage lending industry grew increasingly inadequate. The result was increasingly risky behavior of mortgage lenders, particularly in the subprime market. In recent years, a majority of subprime mortgages peddled to consumers have not been structured or underwritten to sustain homeownership; rather they were intended to lock borrowers into a financial relationship with mortgage brokers and mortgage finance companies whereby loans had to be refinanced, usually within two to three years, in order for mortgage payments to remain affordable. With each refinancing came another set of upfront broker and mortgage finance fees and servicing and securitization revenue. Securitization of the underlying assets allowed the risks of these products to be spread widely, literally to investors around the world (Landler, 2007; National Public Radio, 2007; Paletta & Hagerty, 2007; Werdigier, 2007). The result was that billions in profit were made while millions of families were put at high risk for foreclosure.

Subprime lending increasingly became an unstable house of cards, i.e., a market that gave the appearance of performing well, but in reality, required unrealistically high and unsustainable rising home prices. In fact, irresponsible lending practices contributed greatly to the artificial ballooning of house prices by offering homebuyers financing terms that created the illusion of affordability and encouraged them to purchase properties that were far beyond their financial reach. When house prices began to soften in 2005, the foundation began to collapse under the subprime market's house of cards. But it was not until subprime market losses led to the implosion of a billion dollar Wall Street hedge fund (Morgenson, 2007) that the subprime market's woes rose to public prominence and nearly daily press coverage. Today, the subprime market is in shambles, and with it, many of the nation's blue chip financial institutions that supported the subprime market. More than $70 billion in losses have been written off by major banks and investment firms (Mavin, 2007). Billions in additional losses have yet to be recognized. According to Robert Barbera, chief economist at ITG, "there was financial alchemy at work." (Norris, 2007).

Estimating the Damage

According to the U.S. Joint Economic Committee of Congress (JEC), an estimated $71 billion in housing wealth will be lost directly as a result of foreclosures. An additional $32 billion in housing wealth will be lost indirectly by the spillover effects on neighboring properties (Joint Economic Committee, 2007). The Center for Responsible Lending estimates this combined loss of housing value at $164 billion (Schloemer et al., 2006). Moreover, recently released studies indicate the financial trauma will not be limited to losses in housing equity. As house prices slide, so do local real estate-based taxes. According to the U.S. Conference of Mayors, ten states alone will lose an estimated $6.6 billion in local revenue this year (Global Insight, 2007). That same report projects a one percentage point reduction in GDP growth, with a concomitant loss of more than a half a million jobs (Global Insight, 2007). The Wall Street Journal reports total estimated losses from subprime and similar mortgages on the order of the S&L crisis of the 1980s, ranging from $150 billion to $400 billion (Ip et al., 2007).

[1] An exception to this circumstance may be loans sold to Fannie Mae and Freddie Mac whereby the Government Sponsored Enterprises tend to have more strict underwriting guidelines and more aggressively exercise recourse for loans that do not conform to those underwriting requirements.

According to Martin Feldstein, President and CEO of the National Bureau of Economic Research, the chance of a recession is likely (Isidore, 2008; Berner & Greenlaw, 2007). The prospect of a recession is particularly troubling because an increasing loss of jobs will further destabilize the housing markets by placing an even greater number of borrowers at risk of foreclosure. And, if the stock market's performance in the opening days of 2008 is an indication of things to come, 2008 will be a difficult year. Stock market losses in the first three days of 2008 were the largest opening year three-day loss since 1932 (Karmin, 2008). Moreover, unlike the 2001 recession, consumers will not have the same access to home equity to help them weather the economic storm. Economic distress could also further expose weaknesses in the prime market and its growing troubles with pay-option adjustable mortgages or option ARMs (Reckard, 2007). Resets on option ARMS – which were mostly limited to the prime market – will peak in 2009 and 2010 (Credit Suisse, 2006).

The ripple effects of this foreclosure crisis are not limited to the US. Securities backed by US subprime loans have been sold around the world and are impacting businesses and international markets. In September 2007, for example, subprime losses caused a run on the British bank Northern Rock, which prompted the Bank of England to issue a blanket guarantee of all deposits at U.K. banks (Werdigier, 2007). On November 12, 2007, the Asian equity markets fell sharply, in part, on US subprime market fears (National Public Radio, 2007). In December, Europe's Central Bank poured an unprecedented half trillion dollars into the financial system for short-term loans to banks hoping to avert a year-end meltdown in Europe's money markets (Paletta and Hagerty, 2007). In fact, even the remote fishing village of Narvki, in Norway, was reported to have been harmed by the US subprime market's collapse, due to their purchase of securities backed by US subprime loans (Landler, 2007).

The economic damage from the foreclosure crisis may not be limited to market losses. Legal actions are rising and may have a further chilling impact on lending. On January 8, 2008, the Mayor and City Council of Baltimore announced a lawsuit against Wells Fargo charging lending discrimination against black homebuyers (Morgenson, 2008; Mayor and City Council of Baltimore v. Wells Fargo, 2008). The suit claims that in 2006, 65 percent of loans made by Wells Fargo to black customers in Baltimore were high-cost mortgages; only 13 percent of loans to white customers were high-cost. A few days later, on January 11, the City of Cleveland sued 21 banks for their alleged inappropriate role in financing failed subprime mortgages in that city (Pierog, 2008). Depending on the success of these cases, other cities may follow suit. Also at this time, at least two states are pursuing legal actions against mortgage lenders for discrimination or fraud (Irwin & Johnson, 2008).

Finally, in January 2008, the FBI announced an ongoing criminal investigation of 14 companies for possible fraud in the subprime mortgage market. Although the names of the companies have not yet been released, fraud has been identified in all areas of the subprime mortgage market including; fraudulent underwriting, scam foreclosure rescue schemes, accounting fraud, insider trading, and trading of replicated mortgages on the secondary market. According to the FBI, mortgage fraud has been on the rise for the last few years, with the number of suspicious activities complaints rising from 3,000 in 2003 to over 48,000 cases in 2007, and is spreading nationwide (CNN, January 2008). The FBI is also working with the Securities and Exchange Commission, in its conduct of about three dozen civil investigations regarding the role of mortgage brokers, investment banks and due-diligence companies involved in the underwriting and securitization of loans. (Perez and Scannell, 2008). Dozens of lawsuits are piling up involving homeowners, lenders, Wall Street banks and investors (Bajaj, 2008).

Disproportionate Impact on Minorities

While high foreclosures are impacting families across the income and racial/ethnic spectrum, the families and communities most negatively impacted are African American and Latino. According to a 2006 Federal Reserve study, fully 45 percent of home loans to Latino households and 55 percent of home loans to African Americans, then outstanding, were subprime. These utilization rates of subprime lending are three to four times that of non-Hispanic white families (Avery et al, 2006; NCRC 2003; NCRC 2007).

According to a 2008 report by the nonprofit policy center United for a Fair Economy, the foreclosure crisis will result in the greatest loss of wealth for people of color in recent US history. They estimate black/African American borrowers will lose between $71 billion and $122 billion, while Latino borrowers will lose between $76 billion and $129 billion (Rivera, 2008). As with other estimates of prospective economic impact, mentioned earlier in this paper, the preciseness of these numbers is unclear. But even if the estimates provided by United for a Fair Economy overstate the economic damage by a full 50 percent, the resulting damage on asset holdings for African Americans and Latinos would remain staggering for those households given their relative low wealth status at the outset.

Justification for Intervention

One of the most frequently expressed arguments against assisting homeowners facing foreclosure is concern for the moral hazard of aiding consumers who knowingly made risky choices. The most popular reflection of this sentiment is captured in the phrase "liar loans" which refers to low- or no-documentation loans on which it is argued that borrowers knowingly and intentionally provided inaccurate personal financial information. While it is likely true that some homeowners intentionally misled lenders about their incomes and savings, it is equally true that solicitation of factual information by subprime lenders was wanting. It is also likely that borrowers actually submitted truthful information about their employment and income. Later, unknown to the borrowers, the brokers may have inflated income or assets on the final loan application and failed to point out those inflated numbers when they had the borrowers initial the final loan applications at closing. It is plausible also that many financially non-sophisticated borrowers likely followed the lead of their brokers or lenders and provided information consistent with that which was required of them. Still other borrowers may have had no real understanding of the information contained on the contractual documents they signed. While the truth of what actually occurred is likely some combination of all of these explanations, the bottom line is that the problems now stemming from low- and no-doc loans could have been prevented if lending regulations had required more rigorous and serious documentation from borrowers in the subprime market.

While no-and low-documentation aspects of loan underwriting are important components of the foreclosure problems currently faced, they were not the only form of abuse. Many additional abuses contributed greatly to the current crisis including adjustable-rate mortgages with high payment shock, steering of borrowers to high cost loans, underwriting borrowers only at introductory rates, failure to include taxes and insurance when qualifying borrowers for loans, abusive and unearned broker fees, fraudulent appraisals, and failure to establish escrow accounts for borrowers. Few of these provisions or actions were in the control of borrowers; most of these actions provided no compensating benefits for borrowers that would have encouraged them knowingly to capitulate to the broker's/lender's terms (National Community Reinvestment Coalition, 2005).

The excessive abuses that have permeated the subprime market demand a comprehensive regulatory framework to ensure this behavior will not reoccur in the future. Failure to regulate the subprime market adequately has threatened the financial well being of millions of families, as well as the economy at large. In fact, most borrowers, prime and subprime, are now paying for the abusive subprime market activities, not just those who took out subprime loans. Nationally, home prices are down more than 5 percent with the prospect of a 15 percent or greater decline by 2009 (Makin, 2008). According to the Commerce Department, new home prices have fallen a full 13 percent nationwide with even greater home price declines in areas

hardest hit by this crisis, such as California, Nevada, and Florida (USA Today, 2007). Falling home prices introduce greater volatility in the housing market by squeezing the equity from owners.

Moreover, available evidence does not support the argument that lenders and servicers can address the foreclosure crisis through voluntary loan workouts. According to Moody's Investors Service, only 3.5 percent of loans scheduled for interest rate resets in the first nine months of 2007 were modified. (Marfatia, 2007) Further, the Mortgage Bankers Association finds that fully 40 percent of subprime adjustable rate mortgages (ARMs) that went into foreclosure in the third quarter of 2007 were loans that had previously experienced a modification or repayment plan (Brinkmann, 2008). The principal challenge with the majority of current loan modifications is that they provide only temporary relief to consumers, rather than offering long-term affordable mortgage solutions. Temporary freezes in interest rates for relatively short periods of time, payment plans that add late payments and fees to the outstanding loan principal balances, and loan adjustments that address mortgage affordability, but do not take into account severe losses in home values, are typical of relief now offered.

Although the current credit crunch has squeezed much of the irresponsible and abusive lending practices from the subprime market, strong anti-predatory lending legislation is needed to ensure those practices do not return when housing markets recover. Legislation should address every aspect of the lending process including product type, underwriting standards and criteria, payment shock, special features (such as prepayment penalties), broker fees, appraisal standards, steering and marketing, and lender and securitizer accountability. Although many important improvements to the regulatory environment could be achieved through regulatory agency rule-making, legislation can address more comprehensively each institutional entity in the lending process. Moreover, legislative mandates would provide meaningful private relief to borrowers and have a greater level of permanency.

Both the Administration (Office of the Press Secretary, 2007) and Federal Reserve (Federal Reserve Board, 2007) are now on record acknowledging that unfair and deceptive practices contributed to the current foreclosure crisis. Moreover, a case can be made to assist families who knowingly made risky decisions. Consumers, for example, do not have the option to waive inspection of their vehicles even through millions might forgo the time and money for mandatory state inspections if allowed. Safety inspections for cars, as well as minimum safety standards for electrical appliances, toys, food, and other products protect consumers from personal harm, as well as damage to their neighbors. Regulating the markets – in a manner that provides a safe and sound financial environment and protects consumers from making risky choices that are beyond their reasonable ability to calculate, comprehend, or manage fully – is a reasonable role of government. As a result, rather than perceiving foreclosure intervention as a borrower bailout, it can better be justified as a bailout of the economy in response to lax regulation of the markets.

Current Initiatives

Although news on the foreclosure crisis is aired and printed on a daily basis, little assistance is available for consumers at risk of losing their homes. And, despite the growing and widely recognized existence of predatory lending, no national anti-predatory lending law has been enacted. The most significant initiatives currently available to at-risk homeowners are the HOPE Hotline initiative (offering borrower counseling), managed by the NeighborWorks Center for Foreclosure Solutions and the FHASecure program managed by the FHA. Also active is the National Homeownership Sustainability Fund (providing loan workouts and refinancing) managed by the National Community Reinvestment Coalition, and a similar initiative managed by the Neighborhood Assistance Corporation of America, the Home Save program.

Proposed, but not yet fully operational, is a proposed voluntary freeze on interest rates for select borrowers with adjustable subprime loans, as part of a HOPE NOW Partnership, led by the Department of the Treasury. Related to anti-predatory lending regulations, new rules have

recently been proposed by the Federal Reserve Board. Also pending is floor action on anti-predatory lending legislation in the US Senate. An anti-predatory lending bill has recently passed in the US House of Representatives. Reform of the bankruptcy code is also being considered.

The NeighborWorks HOPE Hotline and FHASecure

The NeighborWorks HOPE Hotline is offered by the NeighborWorks Center for Foreclosure Solutions. NeighborWorks provides foreclosure prevention counseling through a toll-free 800 number. Consumers calling the HOPE hotline are generally referred to lenders participating in the Treasury HOPE NOW Alliance. As of the third quarter of 2007, that hotline was receiving 1,130 calls each day, resulting in nearly 199 foreclosure preventions daily. However, because the program does not have access to a refinancing option, as many as 87 of the 199 daily foreclosure avoidances (or more than 40 percent) result in selling of the home. Only 112, or 10 percent, of all calls received per day result in loan workouts. And even then, the details of those arrangements, and therefore the sustainability of the resolutions, are not known. A recent Congressional appropriation of $200 million to the NeighborWorks program should enable the HOPE Hotline to expand its network of foreclosure counseling agencies and improve its reach in assisting borrowers at risk of losing their homes. While it is not immediately known why so many foreclosure avoidances result in the loss of the home, providing the program with access to refinancing resources would enhance greatly the program's ability to assist families to maintain their homes.

The FHASecure program, introduced in August of 2007 and managed by the Federal Housing Administration (FHA), provides additional flexibilities in FHA underwriting guidelines that open the door to refinancing for borrowers who have good credit histories but cannot afford higher mortgage payments due to a loan reset (Office of the Press Secretary, 2007). Within the first three months of operation, FHASecure received more than 120,000 applications and assisted 35,000 homeowners to refinance their home loans. The FHA estimates it expects to assist 300,000 homeowners by the end of 2008. While not inconsequential, this estimate falls far short of the estimated more than two million households facing foreclosure (Office of the Press Secretary, 2007).[2]

NCRC National Homeownership Sustainability Fund

The National Homeownership Sustainability Fund (NHSF), managed by the National Community Reinvestment Coalition (NCRC), provides loan workouts and refinancing. NHSF assists families who hold high-risk mortgages or have experienced a change in financial circumstances that undermines their ability to repay. The program is a national effort with more than thirty participating NCRC member organizations in 15 states. It has assisted over 5,000 borrowers and estimates it has preserved $500 million in home equity.

NHSF is unique in that borrower assistance is not limited to counseling services. This is important because after receiving counseling, many borrowers remain unprepared to engage successfully in the detailed and sophisticated conversations required to rework a loan. This reality can be observed in the limited success of counseling programs currently to mitigate foreclosures. NHSF goes beyond counseling borrowers by providing homeowners with expert mortgage advisors, who work on behalf of consumers, to tackle the complex and technical issues involved in a successful loan workout or securing refinancing. Beyond restructuring and refinancing loans, NHSF provides insight into unfair and deceptive lending practices that are unavailable without access to detailed loan files. Information gained through individual loan files has contributed to NCRC policy recommendations for new legislation, improved regulation and potential lawsuits (National Community Reinvestment Coalition & Woodstock Institute, 2006). Although relatively small in capacity to date, the real value of NHSF is its successful borrower support and assistance format that could become the model for a greatly expanded and successful federally supported homeownership sustainability program.

[2] Although the FHASecure program is designed to assist consumers who would not qualify for existing FHA insurance, more than 98 percent of borrowers assisted to date would have qualified for existing FHA products; only 541 borrowers who are the primary focus of FHASecure, have been aided (Paletta, 2007).

Other statewide and regional initiatives have been launched but are too numerous to be articulated in this article.

Neighborhood Assistance Corporation of America Home Save Program
Similar to the NCRC National Homeownership Sustainability Fund, the Home Save program, operated by the National Assistance Corporation of America (NACA) provides assistance that extends to helping borrowers refinance high cost loans. NACA offers several forms of assistance including a payment plan for borrowers with an affordable mortgage who are experiencing a short term financial setback, loan modification for homeowners that have an affordable payment but have experienced a long term financial setback, and loan restructuring or a refinance product for homeowners with high cost or otherwise unaffordable mortgage loans. In the fall of 2007, NACA announced a major partnership with Countrywide whereby Countrywide borrowers can receive assistance from NACA services. Participants in the Home Save Program complete a mortgage submission online, attend a workshop to learn about the process and options, meet with a mortgage consultant, are referred to an underwriter and ultimately have their file submitted to the lender for review. With 33 offices nationwide, NACA has committed one billion dollars to help homeowners (Home Save Program, 2008).

Other statewide and regional initiatives have been launched but are too numerous to be articulated in this review.

U.S. Department of Treasury
On November 29, 2007, the U.S. Department of the Treasury announced an initiative to help troubled homeowners. The plan divides borrowers into three categories:

1. Homeowners who are more than 60 days delinquent or already in the foreclosure process (including those whose interest rates reset prior to January 1, 2008)

2. Homeowners who are facing a reset in their mortgage rate (on or after January 1, 2008) and are current on their loan payments, but are deemed to be able to repay the loan following reset; and

3. Homeowners facing a reset in their mortgage interest rates (as of January 1, 2008), but are deemed unable to pay the reset rate or refinance

The plan helps only one group of homeowners: those who face a rate increase but are deemed unable to pay the increase. For this group it recommends a five-year freeze on mortgage interest rates at their initial teaser rates. The plan is of limited assistance since it addresses only a small share of impacted borrowers. Analysts from Deutsche Bank forecast that only 90,000 of the 2.918 million borrowers who took out subprime adjustable-rate mortgages in 2004 through 2007 (approximately3 percent) will meet the requirements for relief under the plan (Shenn, 2007). In a separate study, the Center for Responsible Lending also estimates the plan will reach about 3 percent of at risk homeowners (CRL 2008). In fact, examining the details of this class of qualified borrowers offers insight into the narrow definition of who actually qualifies: "Owner-occupant borrowers with weak credit and a solid payment history on their securitized ARM loan with initial fixed rate of 36 months or less, originated between 1/1/05 and 7/31/07, with a LTV (loan-to-value) ratio of over 97 percent and which has an initial interest rate reset between 1/1/08 and 7/31/10 that will result in a payment increase of over 10 percent" (Rengert, 2008).

Yet, even for those borrowers, the plan also faces a range of technical problems. Of primary concern is that most subprime loans are held in securitized loan pools. Freezing loan rates or reducing loan principal would constitute a change in the contractual terms of the subprime mortgage backed securities that could only be accomplished in conformance with pooling and servicing agreements between the investors and servicers or, barring that, with permission of the investors holding the security. Many pooling and servicing agreements, however, limit loan modifications to five percent of the loan pool. Where pooling and servicing agreements require

an amendment to accommodate more loan modifications, it is unlikely that investors holding highly rated securities will voluntarily submit to receiving lower returns in order to help borrowers avoid foreclosure. Interviews with investment banking executives and experts do not look promising. According to Tom Deutsch who represented the American Securitization Forum in the development of the Treasury plan, "the rate freeze is totally voluntary and will be based totally on what investors decide is in their self-interests. There is no mandate here" (Andrews, 2007). And, according to Roger W. Kirby, Managing partner at Kirby McInerney, "Why would anybody in their right financial mind agree to a five-year price freeze..? "(Andrews, 2007, Makin, 2008).

If investors do agree to a 5-year freeze in rates, it is not clear how valuable that remedy would be in the long run. The plan does not indicate what might change for homeowners over the next five years that will enable them to pay an amount they cannot afford today. Much of the foreclosure problem faced today is directly attributable to borrowers accepting unaffordable mortgages in hopes that future home price appreciation will bail them out. Ironically, the Treasury's five-year solution relies on the same house of cards strategy that led to the current crisis. Moreover, few housing economists see house prices recovering sufficiently within the next five years to enable hundreds of thousands of homeowners to refinance successfully out of their high-cost mortgages. (Appelbaum 2008). The net effect of this plan would be to postpone the foreclosure crisis further into the future if home prices do not recover as desired. This could have a chilling long-term impact on home prices.

In addition, issues of fairness are raised by making only one of the three classes of borrowers mentioned above eligible for assistance. For example, the plan does not assist borrowers who face a reset, but are estimated (based on credit scores of 600 or higher) to be able to repay their loans. In other words, homeowners who have acted responsibly by remaining current on their loans and managed the difficult financial tradeoffs in order to maintain good credit scores, are penalized by the plan. As such, it flips the concept of risk-based pricing on its ear by enabling borrowers with low credit scores to receive low cost loans while requiring consumers with high credit ratings to pay the higher loan interest rates. Finally, it neither assists the economy nor promotes fairness to abandon borrowers who already have mortgages they cannot afford. Hundreds of thousands of families are currently in the foreclosure process. And, similar to homeowners whose rates do not change until this year, many were the victims of predatory lending or an otherwise poorly regulated mortgage market. Helping them retain their homes would have an immediate, positive impact on their communities and local economics.

Federal Reserve Board Proposed Anti-Predatory Lending Rules

On December 18, 2007, the Federal Reserve Board proposed a series of new rules aimed at purging unfair and deceptive lending practices from the mortgage market. The proposed rules address almost every aspect of the lending process. As such, they demonstrate the pervasiveness of predatory lending in the home mortgage market. At the same time, many of the proposals would limit, but not remove abuses from the market. Abusive broker fees, for example, are addressed by a requirement for greater disclosure. This rule would fail to protect consumers who have no idea of how much of a fee is reasonable or typical. Brokers remain able to charge as much as, if not more than, two full percentage points above what is required by a lender to close a loan. As a result, financially unsophisticated borrowers whose experience with the mortgage market is the weakest, would remain the most vulnerable to unfair and abusive fees.

The rules also, for example, require escrow for taxes and insurance for subprime loans; but, it allows borrowers to opt out of escrow after the first year. The only value of an opt-out would be to lower monthly mortgage payments. Inasmuch as taxes and insurance will, nevertheless, need to be paid, the value of the opt-out provision is unclear. This flexibility predisposes financially vulnerable consumers to making financial decisions that are not in their best interest or that of the housing finance system. Prepayment penalties, that have not been shown to provide any benefits to borrowers in the subprime market, are further restricted, but continue to be allowed. Several other provisions provide greater safety for consumers but fall short of fully purging the most harmful predatory lending practices from the subprime market. A 90-day comment period will enable thorough consideration of these and other measures. Rather than a one year opt-out,

a more appropriate approach might be to require escrow until private mortgage insurance is no longer needed.

Pending Anti-Predatory Lending Legislation
The U.S. House of Representatives recently passed an anti-predatory lending bill (HR 3915). This marks a starting point for effective legislation by addressing a range of unfair and deceptive practices. The bill as passed, however, allows brokers to continue steering customers toward high-cost loans and charging excessive and unjustifiable mortgage broker fees. Similar to the FRB proposed rules, the bill, for example, allows excessive broker fees with disclosure of those fees. Yet financially vulnerable borrowers have no way of determining which fees are appropriate and how much is too much. Failure to rein excessive mortgage broker fees will continue to leave homebuyers paying substantially more for their homes than is required based on their incomes and credit scores. In addition, this practice will continue predisposing consumers to greater risks of default. Moreover, the more financially vulnerable consumers are, the more likely they will be exploited through excess fees. This means moderate income and minority working families, as well as the elderly and women, will remain the disproportionate targets of subprime mortgage lending abuses.

The legislation also provides little additional accountability for securitizers who package and sell loans. Failure to hold lenders and securtizers accountable for packaging and selling products that involve unfair, deceptive, discriminatory or fraudulent terms, leaves the financing pipeline open to that behavior in the future. More stringent legislation has been proposed in the Senate (S.2452). That bill, as drafted, would eliminate the most serious predatory lending practices from the home mortgage lending market. At the time of this writing, however, its potential for passage is unclear.

Bankruptcy and Tax Law
Modification of loan terms, in the context of a bankruptcy proceeding, could offer immediate relief to homeowners currently facing foreclosure. But current bankruptcy law excludes the altering of loan terms on principal residences (Rao, et. al., 2007). Amending the code could enable judges in bankruptcy proceedings to examine loan characteristics to determine whether alternative arrangements might enable borrowers realistically to maintain their properties. It could also allow judges to determine whether loans contain characteristics that are suggestive of unfair and deceptive practices and specifically take these issues into account when modifying loans. HR 3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007, amends federal bankruptcy law to allow bankruptcy judges to modify home mortgage loan terms. Although controversial, reform of the bankruptcy code could provide one of the most direct and immediate routes to foreclosure avoidance.

Vacant and Abandoned Properties

There is no proposed initiative that addresses the issue of vacant and abandoned properties. Because subprime lending is particularly concentrated in minority communities, and minority communities are the most financially vulnerable, the prospect of huge inventories of vacant properties in these areas is significant. While excessive levels of foreclosures can severely negatively impact even the most vibrant middle-income neighborhoods, large inventories of foreclosed properties in fragile minority areas can eviscerate the housing wealth of entire communities. In addition to foreclosure mitigation initiatives, important attention should be aimed at finding ways to secure vacant properties that are abandoned directly due to foreclosure, and return them quickly to productive and affordable use.

Broader Solutions Needed

The scale of the current foreclosure crisis, limitations on what qualifies borrowers for assistance by the various initiatives, limitations on proposed solutions (5-year interest rate freeze), and the technical difficulties involved in changing the underlying terms of mortgage assets held in

securitized portfolios, all suggest the need for a more comprehensive remedy. When faced with a major foreclosure crisis resulting from the economic turmoil of the Great Depression, the federal government responded with a new housing finance agency, The Home Owners Loan Corporation (HOLC). A similar entity, the Resolution Trust Corporation (RTC), was established in the 1980s to aid in the clean-up of the failing savings and loan industry.

During the 1930s, for example, most loans were short-term and required refinancing to maintain homeownership. HOLC issued government bonds and refinanced consumers into long-term affordable fixed-rate mortgages and closed its doors seven years later after having stabilized the housing market. HOLC issued over one million loans between 1933 and 1936 and ended its operations as a solvent institution a few years later. Wall Street Without Walls, in cooperation with the Ford Foundation, and separately, the Center for American Progress, have recommended alternative strategies for foreclosure intervention that build on the HOLC concept (McCarthy & Ratcliffe, 2007; Jakabovics, 2007). Visiting American Enterprise Institute scholar John Makin, has suggested an RTC-type resolution mechanism might be considered (Makin, 2008).

An alternative proposal being developed by the National Community Reinvestment Coalition builds on the HOLC model, but relies on existing institutions such as FHA, Fannie Mae, Freddie Mac, or the Federal Home Loan Banks to provide financing or insure loans (NCRC, 2008). By avoiding the added time that would likely be required to create and staff a new agency, this proposal could become operational in much less time. The NCRC proposal recommends that the federal government offer to purchase, at a discount, loans held in securitized pools. Discounting the purchase of loan pools would strike a balance between assisting homeowners and ensuring that lenders and securitizers are not rewarded for financing predatory loans. Borrowers would then be allowed to refinance their loans at terms that are reasonable for their financial circumstances.

In addition to being affordable, fixed rate, self-amortizing mortgage products, refinanced loans would have their initial principal balance adjusted to reflect the current appraised value of the home. The discounted value of the home would be captured by the government in the form of a soft second mortgage, to be repaid at the time of the sale or refinancing of the home, from the home's future appreciated value. There would be no repayment obligation by homeowners required in excess of that which could be captured by appreciation. Losses would be borne by the federal government. Nonprofit intermediaries, that have expertise as home loan counselors, mortgage advisors, or lenders, would be funded to contact and assist borrowers to refinance. Studies have shown many borrowers are wary of contacting their lenders or servicers to request assistance. Given the level of unfair and deceptive practices in the subprime market, this concern is understandable.

The final piece of the proposal would empower the US Department of Housing and Urban Development (HUD) with expanded authority and resources to develop a plan, work with nonprofit development organizations to address foreclosed and vacant and abandoned properties. The focus of HUD's efforts would be to ensure that properties are returned to productive *and affordable* use as quickly as possible. As part of this program, consumers who have recently experienced a foreclosure would have a right of first refusal to repurchase their homes, assuming those properties are part of the program's REO inventory and assuming borrowers qualifiy for a mortgage under the new program guidelines. Regarding other vacant and abandoned properties, HUD might rely on or borrow from major successful initiatives (such as the City of Chicago's *Troubled Building Initiative*[3]) or institutions (such as Smart Growth America[4]) with expertise in the field.

[3] Since 2003, the Troubled Buildings Initiative, part of the city of Chicago's department of Housing, compels landlords to maintain safe and drug-free environments for City residents. Primary areas of concern include neighborhood gang and drug activity, disconnection of utilities that place residents at risk, and lack of maintenance or repairs that creates dangerous conditions for residents. The city partners with non-profit organizations to reclaim foreclosed, vacant and abandoned properties to strengthen city blocks and neighborhoods. In the first three years of the program, over 2,500 units were rehabilitated or repaired.

Conclusion

Many economists propose allowing the market to correct itself despite the reality that this approach would leave millions of families to slip into foreclosure. But, given the role that unfair and deceptive practices have played in creating the current crisis, and the reality that *all* Americans are paying the cost of regulatory failure, responsible public policy demands a thoughtful and meaningful response. As Harvard University Law Professor Elizabeth Warren points out, families have better consumer protection buying a toaster or microwave oven than purchasing a home (Warren, 2007). Recently, thousands of toys with lead-based paint were found to be imported into America. If those toys with lead-based paint had been allowed to remain on the market to the point of harming our children, providing compensation to families would not be referred to as a "bailout." Responsibility would have been accepted at the national level for failing to protect American consumers and immediate intervention would have ensued. And the companies that were negligent in their duty to protect the public would have been held accountable. The time has come to help consumers who have been financially damaged by failed regulatory policy in the mortgage arena as well.

Now is the time to eliminate predatory lending practices from occurring in the future. Just as it would not have been an acceptable compromise to have removed some, but not all, lead-based toys from the store shelves; it should not be acceptable to remove some, but not all, unfair and deceptive practices from the mortgage markets. The American public deserves better. Moreover, additional efforts should be made to ensure the U.S. financial services system, in general, works for everyone. Financial services in low- and moderate-income and minority working communities are generally high cost and counter-productive to building savings and good credit histories (Carr & Schuetz, 2001; Casky, 1004; Stegman, 1999). Legislative mandates to ensure more equitable credit availability, such as the Community Reinvestment Act, Equal Credit Opportunity Act, Truth in Lending Act and Home Ownership and Equity Protection Act should be continuously updated to accommodate changes in the financial services market place. Moreover, CRA and related acts must be meaningfully enforced. Expansion of CRA coverage to a broader class of financial institutions, for example, could have prevented much of the subprime market's worst abuses. Most of the subprime market's unfair and deceptive practices were the work of non-CRA covered mortgage lending institutions.

Finally, federal investments in financial innovation for disadvantaged communities are also warranted and overdue. Innovative products, such as Shared Equity Mortgages, that could better align the interests of investors and borrowers, have great potential (Caplin et al., 2007). Shared equity mortgages allow investors to take an equity stake in homes, usually repaid by the long-term appreciating value of homes. Because investors gain when homeowners sustain their homes and housing markets are healthy, investors and homeowners have a common financial interest. In addition, innovative savings and consumer credit programs have been documented or promoted by a range of research and policy institutions such as the Center for Financial Services Innovations, Center for American Progress, The Brookings Institution, the New America Foundation, United for a Fair Economy, and the Insight Center for Community Economic Development. Federal support, which could move pilot programs and demonstration initiatives to larger-scale efforts, has unfortunately been lacking. The current crisis demonstrates that one key component to a robust and sound economy is the inclusion and full participation of all households in an efficiently functioning and responsibly regulated financial system. The National Community Reinvestment Coalition, under the rubric of the "Financially Inclusive

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(City of Chicago website. 2008)

[4] The National Vacant Properties campaign is a joint partnership between Smart Growth America, LISC and the Metropolitan Institute at Virginia Tech. The goal of this campaign is to help communities prevent abandonment, reclaim vacant properties, and once again become vital places to live. The campaign builds a national network of leaders and experts; provides tools to communities; raises awareness through communications; and provides technical assistance and training. The National Vacant Properties Campaign has worked with nonprofits, elected officials and residents in 14 states. (*National Vacant Properties Campaign Website. 2008)*

Society," is examining ways in which the many thoughtful financial innovations that have been developed over the past decade, can be better prioritized and organized into a comprehensive legislative proposal, that might one day lead to true equality of access to financial services for all Americans.

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About NCRC

The National Community Reinvestment Coalition (NCRC) is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, local and social service providers from across the nation.

Mr. JOHNSON. All right. Thank you, Mr. Carr.

Now we will——

Mr. CANNON. Mr. Chairman, may I ask unanimous consent to include the statement of Mr. Chabot in the record?

Mr. JOHNSON. Sure.

Mr. CANNON. Thank you.

Mr. JOHNSON. Without objection.

[The prepared statement of Mr. Chabot follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE CHABOT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO, AND MEMBER, COMMITTEE ON THE JUDICIARY

Statement Congressman Steve Chabot
Commercial and Administrative Law Subcommittee Hearing on
Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths
January 29, 2008

Madame Chairwoman, thank you for holding this hearing today. News reports continue to highlight the devastating impact that the subprime mortgage crisis has had, and continues to have, not just on the hundreds of thousands of homeowners who are being foreclosed on, but on the neighborhoods and communities across the nation that have been affected through lower property values.

I would also like to welcome and thank my good friends, former Congressman and HUD Secretary, Jack Kemp, and Wade Henderson, Executive Director of the Leadership Conference on Civil Rights, and our other witnesses, for taking the time to be here to discuss this situation and the options that Congress has before it.

As you all know, I've worked with Judiciary Committee Chairman Conyers; the Chairwoman, Ms.Lofegren; and Mr. Miller on bipartisan legislation that we believe is a necessary complement to the House's efforts last year, and the Administration's efforts, to address this devastating crisis. Because of ~~the many misrepresentations that have been made recently~~ A LOT OF MISINFORMATION THAT'S OUT THERE, I think it's important to point out what the bill as reported out of the Judiciary Committee would and wouldn't do.

First, and most importantly, this bill will enable MANY families to keep their homes, while at the same time ensure that monthly mortgage payments continue to lenders. The bill gives bankruptcy judges the discretion, let me repeat that – the discretion – to modify a mortgage payment to the fair market value of a primary residence; waive any prepayment penalties; or waive excessive fees associated with mortgage payments, among other remedies, to help ailing homeowners.

What this legislation is not – is an open-ended permanent change to our bankruptcy code. This bill is limited in scope and duration providing the market with the certainty it needs to adjust. For example, the temporary changes affect existing loans only - those made beginning in 2000 through date of enactment of this legislation. It does not allow future loans to be modified. Second, the bill targets only those families who will otherwise lose their homes to foreclosure. The Paulson plan, while well-intended, does not help those who are already in foreclosure or face imminent foreclosure. Third, the bill targets only those homeowners who received loans that the banking regulators have identified [illegible] to be potentially dangerous and subject to abuse – subprime and nontraditional mortgages. Conventional loans are excluded from this bill. Finally, the legislation provides clear guidance to judges about the extent to which loan terms may be adjusted. Judges cannot deviate from the parameters of the bill.

I don't think anyone here would dispute that the subprime mortgage crisis is a real, and one that is deepening. Moreover, I don't believe anyone here would dispute that foreclosures create enormous costs for the families evicted from their homes; the neighbors who find their own property values diminished and their neighborhood rendered less safe because of a neighboring foreclosure; the state and local governments that lose tax revenue; and this nation's economy as a whole.

The House has already taken steps to prevent future predatory lending practices from occurring. The Administration has taken steps to help keep some homeowners from entering foreclosure. But, nothing has been done to help those who have already fallen victim to foreclosure because of the past lending practices maintained by some. I believe that passage of H.R. 3609 is a step in the right direction, and I am interested to hear what our panel of witnesses recommend as an appropriate remedy for the crisis.

Again, I thank the Chairwoman and our panel of witnesses.

Mr. JOHNSON. Now we will move to questions, and I will take the first few questions, and then I will turn it over to my friend, Mr. Cannon.

Mr. Henderson, some have likened the predatory lending practices in the subprime mortgage industry as the 21st century's version of redlining. What are thoughts about that assessment?

Mr. HENDERSON. Mr. Chairman, there is some truth in that observation, although I think it is important, even in examining the subprime market, that not all subprime lenders should be criticized for the current state of affairs.

Subprime lending played an important role in providing credit opportunities for individuals with impaired credit. The difficulty we are witnessing today, however, is not because of the existence of subprime lending.

It is subprime lending run amok without adequate regulation and an abandonment of communities by conventional lenders, a failure of regulators like the Office of Thrift Supervision, the comptroller of the currency and the Federal Reserve to do what it needed to do to ensure that there was a balance of credit opportunity that included both conventional lenders and subprime lenders, where appropriate.

So the combination of factors that we are witnessing today that led to this difficulty was the existence or creation of new products without appropriate supervision or regulation and extending credit to individuals who clearly did not have the ability to pay and averting the gaze of lenders from circumstances that should have been an adequate warning that the loans that they were advancing were problematic from the outset. And it is that combination of factors that has produced the results we are witnessing.

And one last point. The bankruptcy bill that Mr. Conyers and Mr. Chabot have introduced is a modest step that is intended to inject a pragmatic reality in allowing hundreds of thousands of borrowers to adjust their circumstance without doing violence—without doing violence—to the entire mortgage lending industry. And that is an important part.

Mr. JOHNSON. Thank you. I will note, and I would ask for a response from anyone on the panel, the notion that subprime mortgages have been marketed to persons with credit scores high enough to qualify for conventional loans with far better terms and that it appears that there is some evidence that minorities who could have qualified for the cheaper prime loans instead were steered into the subprime loans—if anyone would care to speak on that issue.

Mr. Carr?

Mr. CARR. The disproportionate reliance of subprime loans with minority communities has been known for years. The State of North Carolina, for example, instituted an anti-predatory lending bill as far back as 1999, and so there is a cacophony of research that tracks this.

The Federal Reserve study showed—I believe it was 2006—that of all subprime mortgages outstanding, 55 percent of loans to African Americans were subprime and 45 percent to Latinos were subprime. A study last year—I believe it was in the third quarter—showed that a substantial share of borrowers in the subprime mar-

ket actually had credit scores—I think it was over 60 percent—that would qualify them for prime mortgages.

And so this issue of steering is something that has been known for years within the housing industry. It has been documented extensively, and it is well known, and it is one of the major concerns with respect to unfair and deceptive practices within the industry.

And I might add that we are already beginning to see the damage to African American households disproportionately as a result of the foreclosure crisis. Between the second quarter of 2004 and 2007, the homeownership rate for African Americans fell by more than 2.5 percentage points, compared to just .06 for non-Hispanic white households.

This is a very distressing circumstance, given the fact that African Americans already have a homeownership rate which is considerably below that of non-Hispanic white households.

Mr. JOHNSON. All right. Thank you.

And I would also point out for the record that a study by the Consumer Federation of America has found that nationwide, women are 32 percent more likely to receive subprime loans than men.

My time just about being expired, I will not yield to my friend from what state?

Mr. CANNON. From Utah.

Mr. JOHNSON. Utah.

Mr. CANNON. But would you mind yielding to the gentleman from Florida, since he doesn't have to stay for this hearing, and I probably do. If we can let him take his 5 minutes, he can go do other things. Then I will take mine later on.

Mr. JOHNSON. All right. Certainly.

Mr. CANNON. Thank you.

Mr. JOHNSON. Sir, you have 5 minutes.

Mr. KELLER. I thank the gentleman for yielding.

There is no question that people are hurting right now, and a time when families are paying higher costs for mortgages, health insurance and gasoline, I think it is morally wrong that we ask them to pay even more of their money in higher taxes and then turn around and use that on wasteful earmark projects.

We have seen progress just today in passing an economic stimulus plan in the House of Representatives, and yesterday President Bush wisely called for a crackdown on wasteful earmark spending in his State of the Union address.

This afternoon we are looking at the third prong, the home mortgage crisis. And the issue before us seems to be should we allow contracts to be modified by the bankruptcy courts? Those folks who are proposing this in their testimony say this is really the one solution these people have facing foreclosure, and they need relief.

The other folks on our panel have testified that this will actually hurt first time homebuyers, because it will result in higher down payments and higher interest costs, and we should instead go with volunteer programs like HOPE NOW and FHA Modernization. They point out that there is a reason the current law for over 100 years has not allowed judges to rewrite these home mortgages.

So let me try to take a balanced approach and get to the bottom of this.

Let us start with you, Mr. Kittle. I have on my credit card a rate of about 9.5 percent, but my home mortgage is about 5.5 percent. There is a reason that we pay a higher cost in credit cards. Is that correct?

Mr. KITTLE. It is.

Mr. KELLER. And the main reason is the credit card is unsecured, whereas the home mortgage is secured.

Mr. KITTLE. That is correct.

Mr. KELLER. And if we allow these mortgages to be rewritten, I know that you have some concerns that this will result in higher down payment costs for first time homebuyers. Is that right?

Mr. KITTLE. Yes, sir. It is.

Mr. KELLER. Give us an idea. Are we looking at a 20 percent requirement for some down payments? Or what do you anticipate here?

Mr. KITTLE. I can give you some precedent, some history.

Mr. KELLER. Okay.

Mr. KITTLE. In 1978, when the bankruptcy law was rewritten—actually the last time—it then included in that legislation investment loans. In 1978, you are the single-family residential owner occupied in an investment loan for the same price. After that legislation, you must have a 25 percent down payment, your interest is as much as three-eighths percent higher, and your fees and/or could be as much as a point and a half more in discount points. That is because cramdown is available on those types of loans.

Mr. KELLER. So you are—and I got that number from the *Wall Street Journal*—are you concerned the home down payments could be as high as 20 percent requirement?

Mr. KITTLE. We are concerned. Exactly.

Mr. KELLER. And from your earlier testimony, you mentioned your concern that interests rates for these first time homebuyers may go up to a percent and a half.

Mr. KITTLE. That is correct. A percent and a half higher. Yes, sir.

Mr. KELLER. You also mentioned a concern about higher closing costs. I wasn't sure what you were getting at there. Does that mean more in origination fees?

Mr. KITTLE. Adding on additional fees because of the additional risk.

Mr. KELLER. Do you have a percent or estimate of what you would see in terms of higher closing costs?

Mr. KITTLE. If it neared the example that I just gave you could be as much as a point or a point and a half in discount.

Mr. KELLER. Okay.

Now, Ms. Schwartz, you have testified that historically about half of the people facing foreclosure didn't even bother to call their lender to renegotiate. Is that correct?

Ms. SCHWARTZ. That is a well-known historic number.

Mr. KELLER. Now, are you seeing some changes to that pattern, now that we have the HOPE NOW program in effect? And what changes are you seeing?

Ms. SCHWARTZ. Well, we are seeing a number of changes. We are introducing the third parties so that homeowners have someone to talk to, an advisor to go to, if they don't care to go to the servicer for whatever reason that might be. And through the HOPE hotline,

an extensive outreach effort, both outbound and inbound, we are seeing a major shift in that number. And we will be reporting on that throughout the year.

Mr. KELLER. It seemed like a very meritorious program. The criticism comes from the other side a little bit that it is purely voluntary. And so what do you say to the person who is facing foreclosure, and his particular lender doesn't participate in HOPE NOW or have similar standards, and so he feels that the bankruptcy option is his only option? What do you say to that person as a remedy?

Ms. SCHWARTZ. Well, I can only speak for the servicers that are part of HOPE NOW, which is a vast majority of lenders in the subprime market servicers.

Mr. KELLER. Okay.

Let me ask Mr. Kittle that same question. What about the person facing foreclosure, and his particular lender doesn't participate in the HOPE NOW type of standards and practices? What do you say to that person as a remedy?

Mr. KITTLE. Well, most all of the servicers that are members of the Mortgage Bankers Association—all of them, as a matter of fact—are linked on our home loan learning center. We give the borrower a direct link to that servicer. MBA will help contact the servicer for the borrower, but we will send them to HOPE NOW and encourage them. And you will contact that servicer, even though they are not a member.

Ms. SCHWARTZ. Oh, absolutely. The HOPE NOW hotline is for everyone to call. And it is prime borrowers, subprime borrowers. That is out there. It is in the public domain.

Mr. KELLER. Mr. Chairman, let me just say my time is expired. I will yield back, but if I had more time—and hopefully some other people do—I was going to ask Dr. Zandi to give the opposite on all those questions. So I was trying to be balanced about it, but my time has expired.

Mr. JOHNSON. Thank you.

I would now turn to Mr. Mel Watt from North Carolina.

Mr. WATT. Thank you, Mr. Chairman.

I actually will pick up in a similar vein, because, as many of you know, I have been talking for the last 3 or 4 years with the lender and borrower consumer community, trying to work out the appropriate balance on the new predatory lending bill that the House passed. And one of the things I have found is that quite often we talk past each other and don't really listen to what people are saying. And we do it to our detriment.

One of the issues that I raised in the very, very first hearing on the original bill that got amended through the compromise with Mr. Chabot that we reported out was that there is some possibility, as Mr. Kittle indicated, that we could be incentivizing people to take the easy route and go into bankruptcy. I think that personally would be a devastating blow to people, if they took that easy route.

After that hearing, I invited the lender community to give me some ideas about how we might be able to remove that what might be a perverse incentive for people to go into bankruptcy. And the lending community decided that it could stop this bankruptcy bill as an alternative to trying to improve it to address the concerns.

So I am still trying to figure out how to remove the perverse incentive. I don't condemn the HOPE NOW project. It is a wonderful project for the people who are able to take advantage of it. But there are some people who are not going to be able to take advantage of the HOPE NOW project, and there is a group of people at the end of the day who won't have any alternative other than bankruptcy.

And what I am trying to find is how we can limit the impact of the bankruptcy cramdown provision to just that group of people, because I have seen the adverse impact that going into easy bankruptcy, or being talked into easy bankruptcy, can have in the business community, in our community as minority individuals. And so I want to focus on that a little bit.

One idea might be to create a gatekeeper, who would make a really serious determination about whether bankruptcy was in fact the only option available to save somebody's home for him. One might be to create a series of findings that a bankruptcy judge might have to make regarding this being the only alternative available.

Mr. Carr, you seem to be shaking your head. You probably have thought about this, because you know how terrible it is for people to end up in bankruptcy as a first resort, rather than as a last resort. Talk to me about how we can remove, possibly, that perverse incentive for people to end up in bankruptcy, because I heard what Mr. Kittle said. I have heard what the concerns are about the bill, and I am concerned about it, too.

Mr. CARR. Absolutely. I think Mr. Kittle raises a very important point, and I think it is worth just going back to the previous question to say I don't know that the objections—it certainly is not in the community in which I travel.

I was just at a meeting with 14 of the largest lenders yesterday. The issue isn't that the plans are voluntary. It is what is it that the private market can realistically offer as a loan modification that actually restructures the loan and makes it permanently affordable? And that is the challenge. And most of the modifications that are happening are not doing that.

While it may be true that the private market led the way in getting us into the problem, the Federal Government has to lead the way in getting us out. And that would lead to give refinancing options that currently don't exist to consumers so that they don't do bankruptcy, which no family optimistically looks forward to claiming bankruptcy. But if that is the only choice that they have, relative to some type of loan modification or payment plan that simply tides them over for another 6 months or 12 months or 18 months, it is not a permanent restructuring.

And I just want to conclude by saying it is important in this environment that we figure out that housing problem, because the same estimates on interest rates one could generate if the housing market continues to deteriorate. And in that light, I think every one of us is on exactly the same page. The question is how do we get consumers into long-term affordable loan products that don't come back to recreate this problem in another year, year and a half, or 2 years from now?

Mr. JOHNSON. Thank you, Mr. Carr.

Mr. WATT. Mr. Chairman, let me just make one final comment on this point, because I think HOPE NOW is great. I think raising the FHA limit is great. All of these things really are tools that need to be in the toolbox, but at the end of the day, there is going to be a group of people who don't have any alternative to bankruptcy. And they need to have a tool also.

So if we could figure out a way to limit this bill and the impact of this bill only to those people as a last resort, I don't know why the lender community would want to fight that, as opposed to going to foreclosure, selling it, selling the house at 50 percent or 20 percent of the value, as opposed to getting 80 percent or whatever the bankruptcy judge thought was a reasonable cramdown figure.

And that nobody in the lender community has been able to explain to me. It is a no-brainer. I yield back. And having asked that question a number of times, I have yet to get an answer.

Mr. JOHNSON. Thank you, Congressman Watt.

We will now proceed with questions from Mr. Cannon.

Mr. CANNON. Thank you, Mr. Chairman.

And Mr. Watt is keenly aware of the fact that we agreed that this is the question. I think it is a hard question to answer, Mr. Watt.

But what I am hearing you say, Mr. Carr, is essentially you don't think that the private sector can do it or could respond quickly enough, and so you support this bill because it brings great pressure to bear on the private industry to act. Am I reading that right?

Mr. CARR. Well, not really. I support the bill, because I think it is an important channel for consumers who, if they don't have access to this bill, will simply lose their homes, because the modifications aren't going to help them.

But I am further saying that we need something that is larger than just this bankruptcy bill as well and the programs that are mostly focused on the voluntary reworking of the mortgages. What is not available is a source of refinancing that is large enough for this estimated two million or so homeowners who are heading into foreclosure.

And I have some recommendations that I can put on the table, but a lot of think tanks, for example, have been talking about reinstituting a homeowners loan corporation, for example, that was established during the Great Depression for a foreclosure crisis that is analogous to now. There are ways we could do that without establishing a new institution.

I am just simply saying I don't think that the private sector can alone completely resolve this problem.

Mr. CANNON. Ms. Schwartz?

Ms. SCHWARTZ. Yes, I would just like to maybe make one slight clarification. It is daunting, but I think we are making real progress.

One thing the American Securitization Forum did to help the process and get to more borrowers, more homeowners, swiftly, quickly and efficiently was to have one scalable solution for the current borrowers, who are currently paying, have the willingness and capacity to repay, before their reset. And that guidance that was issued.

And also a comfort letter offered by the SEC so that services could proceed on behalf of investors to modify loans scalably will start to make a big impact on the future foreclosures that are cited in the many studies. And that is one of the reasons that it was done.

Secondarily, everyone can redeploy their resources to the loan-by-loan delinquent borrowers who need it desperately to see what is the cause for the delinquency. Sometimes it is unemployment, or sometimes there has been a disruption, or perhaps it was the reset that caused it. But whatever those reasons, then they will redeploy all those resources. And yes, it is loan-by-loan, but they have to know what is going on, because that is the servicing agreement with the investor.

Mr. CANNON. Ms. Schwartz, do you think that the private sector can respond in this program quickly enough to solve the problem generally?

Ms. SCHWARTZ. I am not sure we are the only solution, but I can tell you the industry is going across the board with nonprofits and investors, and they are all at the table, and we are doing our best to do what we can to slow down and modify these loans and stop these foreclosures. So we think it is a huge effort, and it is going to show great impact. We already have seen them.

Mr. CANNON. Let me direct a question to Mr. Henderson and Mr. Dodds, because they are sort of on the front lines here.

There is unease about—even Ms. Schwartz acknowledged—that they would be hard to do. I would point out that I read someplace in the last couple of days that interest rates are now nudging down under 6 percent, which is a marvelous tonic for this whole thing.

Ms. SCHWARTZ. Yes.

Mr. CANNON. That is a really, really big deal. But you both represent or have dealt with people who have problems and are struggling with mortgages. You are also both advocates for people owning their own homes, and that means being able to buy in at a relatively cheap rate. I don't think anybody has been critical of the numbers that Mr. Kittle has suggested.

In the balancing that we need to do here, and given the cost, especially the much, much, much higher down payments that we are talking about, we know that people can somehow live with a larger payment, if they can budget it, so the extra point and a half or so in closing costs, people can maybe live with that. But a 20 percent down payment puts most houses beyond most people.

Shouldn't be wary of doing or creating a cramdown in this bankruptcy bill that will put a much higher threshold before people buying houses?

Mr. HENDERSON. Certainly, Mr. Cannon, were that to be the result of the proposal before us today. It certainly would be a cautionary issue worthy of further examination. But having said that, I do not believe that the current bill will result in the loss of homeownership opportunities of the magnitude that you have described. We are back——

Mr. CANNON. Because of the shortness of my time, can I just ask do you disagree with the idea that Mr. Kittle has presented, which we have many times? I think Mr. Zandi also gave us statistics like this in an earlier hearing——

Mr. HENDERSON. Yes.

Mr. CANNON [continuing]. That the down payment is going to go up.

Mr. HENDERSON. I don't dispute the fact that the down payment will go up, but I also recognize that there is a need for a more comprehensive adjustment in the mortgage lending system to prevent that result from occurring.

The question that Chairman Johnson asked earlier about whether there is steering that put a disproportionate number of African Americans, Latinos, women and older Americans in the subprime market is true and well documented.

Having said that, we certainly encourage homeownership opportunity, but that involves a more comprehensive adjustment in the mortgage lending system with more regulation of banks and traditional lenders, fulfilling their fiduciary responsibility in the communities in which they function.

Our particular concern about the notion that voluntary efforts will result in a positive outcome is belied by the fact that over almost a year our organizations have been meeting with groups like the Mortgage Bankers Association and others, trying to seek a more coordinated loan modification program.

We talked about a 90-day moratorium on foreclosures to give both borrowers and lenders an opportunity to restructure these loans. Voluntary efforts have been woefully inadequate, and the evidence of that is borne out by the increasing numbers of foreclosures month after month.

If there is not a modest intervention in the market by the Federal Government, it will be virtually too late to serve those who are actually legitimate borrowers who in fact are in need of support.

And to suggest somehow that Chapter 13 is the easy way out ignores the fact that there has been a substantial adjustment in our bankruptcy laws over the past several years, making the consequence of filing bankruptcy more difficult than ever before. It is not an option of first resort for many people. It is an option of last resort.

But as you saw from some of the people that Mr. Dodds brought with him, the consequences of a failure to address these issues is the loss of home, the loss of equity. And for many people, like African Americans and Latinos, this represents the greatest loss of wealth ever documented in modern times. That is something that we are deeply concerned about.

Mr. CANNON. Mr. Chairman, I see my time has expired. Do we have the possibility of a second round here?

Mr. JOHNSON. Yes, I think that would be appropriate. And if you want to continue with your 5 minutes in the second round, or would you want to wait?

Mr. CANNON. I think I would actually like to continue——

Mr. JOHNSON. All right.

Mr. CANNON [continuing]. Because we are getting to the gist of the argument here. There is a radical agreement on many, many issues here, and we divide on some basic ones.

And so, Mr. Dodd, I would like to hear. Do you basically agree with what Mr. Henderson said?

Mr. DODDS. Yes, I think the voluntary efforts are going to be woefully short for people, though. We are talking about scaling. But in the next year and a half, two million loans are going to be going——

Mr. CANNON. Let me intervene, because you sort of said that earlier, and I really want to get to the deep issues here. People don't voluntarily do things, especially people who are sitting out on the sidelines with investments——

Mr. DODDS. Right.

Mr. CANNON [continuing]. Or with guarantees on investments.

And, in fact, I believe Mr. Zandi, you would like to comment at this point about Moody's role in the subprime problem with its over rating of the mortgage backed securities.

Mr. ZANDI. No, I don't want to talk about that at all. [Laughter.]

Mr. CANNON. All right, but there is a problem. You acknowledge the problem.

Mr. ZANDI. That is not my purview, and I am not part of the rating agency, and I am here as a——

Mr. CANNON. But the point is——

Mr. ZANDI [continuing]. We will go around, and all of us are in this together.

Mr. CANNON. I don't mean to beat the heck out of you right now. The fact is we have so many people, and we have such a complex process that has led to this very high level of homeownership with low down payments, and some abuses.

Mr. Carr, you talked about the abuses.

Mr. Dodds, you talked about the abuses.

Mr. Henderson, you also talked about the abuses.

But you can't have a free marketplace without some rough elbows here and there, not that we should condone rough elbows, but now we are talking about having had a failure, it is one thing to say that it doesn't work very well, but have people go voluntarily in a path.

On the other hand, we are now looking at people who figured it out. They have looked in the gaping jaws of the beast, and they are saying, "We have a big problem." We have got write-offs. Last week's *Business,* we got a list of all the write-offs. It is a stunning—it is a stunning—number of write-offs. And people everywhere have been writing down these kinds of loans.

And so now you have—I think, is it fair to say, Ms. Schwartz, that there is an incentive out there on the part of the private industry to come together and solve the problem?

Ms. SCHWARTZ. Yes. All the incentives are aligned. There is no good outcome in these foreclosures, and we are working hard.

Mr. CANNON. And as I understand—Mr. Dodds, I am going to give you a chance to talk here, but—you have every incentive to keep your people from going to bankruptcy and to working through a system, if you can get these guys in the private sector to work with you. Isn't that the case? Mr. Dodds, yes.

Mr. DODDS. Mr. Cannon, I think one of the big problems is that the lenders are not going to be able to communicate well with these homeowners, that people, when they are in problems, the real world is when people can't pay their bills, they don't open their bills. They put them in corners.

Mr. CANNON. Right.

Mr. DODDS. And that may be——

Mr. CANNON. Look, I agree. I understand. That is a well-taken point. But advocacy groups like you guys can reach out to those people and help facilitate.

Mr. DODDS. You know what happens? When we send letters out, they are getting letters from everybody under the sun. They are getting flooded with letters, and it is very difficult to reach these folks. And one of the groups that has done the best job of reaching them are Chapter 13 lawyers.

Mr. CANNON. Yes.

Mr. DODDS. And I would say not in a good way.

Mr. CANNON. Right.

Mr. DODDS. They put them in bankruptcies they can't afford. They have taken their money, and they have basically done a disservice very often. But right now, if we change this law so that bankruptcy would work, these people will go out and find those homeowners. It will only be a safety valve. It won't be the whole program. HOPE NOW continues. They would find these homeowners, and they would get them in bankruptcy. The judges would——

Mr. CANNON. Mr. Dodds, you are saying that you would trust bankruptcy lawyers to solve the problem, because their financial incentives are better than the guys——

Mr. DODDS. Yes, you are talking——

Mr. CANNON [continuing]. Who face a meltdown of the whole economy after all their investments?

Mr. DODDS. You are talking free market, and part of free market is these——

Mr. CANNON. I grant you. That is part of free market.

Mr. DODDS [continuing]. Finding homeowners and getting them in programs, which the lenders are going to have a hard time doing it. They are already having a hard time doing that.

Mr. CANNON. Let me just take the one point, not to be argumentative, but I think we are getting here to sort of the center of the issue. You have got somebody who gets a whole bunch of bills. He can't pay his bills, because his mortgage payment has gone way up, and he doesn't know what to do. How dumb can a person be to not recognize that there is a big trend in America?

Every single presidential candidate is talking about these issues, and we are argue that they are a small player in a large trend, and all we need to do is tell those people there are forces out there that exist to help them. If we get that message to people, then they come to people like you, and you help them to——

Mr. DODDS. Again, I don't believe we can do the volume. I don't believe that lenders are set up to do the volume. When we did Countrywide, I am telling you, they couldn't even get the stuff through the imaging department in over a month.

Mr. CANNON. That was a great story, Mr. Dodds.

Mr. DODDS. Even if they try, even if they try very well.

Mr. CANNON. What happens in our bankruptcy courts? We hang up the bankruptcy courts in this dramatic fashion with all these guys who got out and hustled business. And now everybody has got a stay on their payments, and now the market is really fouled up.

And I think, Mr. Kittle, you would like to speak. And I think you have been very clear, and I am going to end by giving you the floor.

Mr. KITTLE. Thank you. I feel neglected just a little bit. [Laughter.]

I will just give you one number. In the third quarter of 2007, our servicing members of MBA helped modify, worked out over 236,000 loans in the third quarter. It is on a trend like this. We need the opportunity, along with our members, the market to correct itself, and HOPE NOW to take advantage of lenders who want to help. We are making a difference. We think we can handle the volume.

Mr. ZANDI. I would like to make a point.

Mr. JOHNSON. The time has expired for Mr. Kittle.

I will now move to Mr. Watt.

Mr. WATT. I will let Mr. Zandi respond, because I still think we are really talking past each other here.

I don't think the issue is the numbers at all—236,000. You have got three million people who are in default or are likely to be in default. So at the end of the day, there is always going to be somebody that you are not going to be able to work out. That is the person that we are trying to protect, ultimately, and the person that lenders are so intent on not having some external party make a determination about.

Lenders are not going to be able to do it, so why wouldn't the solution to this require exhausting every other option before you get to bankruptcy? And if your only option is bankruptcy, why is the lender community so resistant to allowing—I mean, bankruptcy was always intended as the last resort.

Mr. Kittle, go ahead and tell me that. I have been waiting on people to tell me.

You tell me, Mr. Zandi, and some on the other side.

Mr. KITTLE. You give Mr. Zandi an opportunity, and I will take it back, if you have time.

Mr. WATT. All right.

Mr. ZANDI. Yes. At the end of last year of 2007, there were 450,000 loans in default, first mortgage loan default. That is the first step in a foreclosure process. Then let us turn to the board and look at the data. In the second half of last year, we saw 250,000 repayment plans and 120,000 loan modifications. When you do the math, they are not all covered.

Second point. Repayment plans do not solve anybody's problem. They make the problem worse for the borrower. They are going to end up in default. All they are doing is taking the interest not paid, rolling it back into principal, and the amount owed monthly going forward is going to rise. So you are delaying the day of reckoning for these people, not by years, but by months. So repayment plans—that means nothing.

Mr. CANNON. Would the gentleman yield for a clarification here?

Mr. WATT. Yes. Sure.

Mr. CANNON. In those repayment plans, don't interest rates get adjusted? So you have got a subprime mortgage that is going to bounce? Are we not adjusting those interest rates?

Mr. ZANDI. Those are modifications. Those aren't repayment plans. No. And in fact in modifications, we don't know what those modifications are. If you listen to the lenders—take Countrywide,

for example, to bring up a case in point—what they are saying a modification is is that we are going to take the interest rate and give these people—it is almost like a repayment plan—give them some chance to repay what they owe over some period of time.

Mr. WATT. And if I can just intone here, part of the problem is the housing prices got bid up so high that the houses aren't even worth trying to keep—a lot of them—anymore, so if you don't cramdown to a manageable value for the house, this is not going to work anyway.

Mr. ZANDI. Mr. Cannon, this is a good idea. It is a laudable plan. It is worth going down this path. But the numbers don't suggest that it is going to solve the problem. It may make a big dent.

And the other point is in terms of the cost, the cost will not rise. I mean, if you look at the Federal Reserve, and they said, "Give your opinion, Freddie Mac, tomorrow. What would be the impact on mortgage rates?" well established research that has been well refereed, gone through the Federal Reserve system, discussed in many times, the number is 25 basis points.

I could go to Fannie Mae and Freddie Mac tomorrow with 25 basis points on a mortgage loan, so how in the world could we possibly get to a point and a half on the mortgage rate, when we are talking about this cramdown bill?

Mr. CANNON. Mr. Watt, would you yield?

Mr. ZANDI. If we get rid of Fannie Mae and Freddie Mac——

Mr. WATT. I have been yielding for the last 5 minutes. Yes.

Mr. ZANDI. Mr. Cannon, if we get rid of Fannie Mae and Freddie Mac, there is no market.

Ms. SCHWARTZ. There is no market.

Mr. ZANDI. It doesn't matter what the percentage is at.

Mr. CANNON. Let me just ask Mr. Watt a question.

Doesn't it seem in this whole scheme, when people have bid up and made improvident decisions on buying houses that are overpriced, that the market ought to be allowed to correct itself, and that we actually really can't affect the whole from——

Mr. WATT. I am a firm believer in the market correcting itself for the people who it can be corrected for. This bill talks about people who—I mean, you know, even the minority issue that Representative Johnson raised, the 60 percent that Mr. Carr talked about that should have been in a prime loan in the first place, they can get their loan refinanced as soon as we raise the cap on FHA. They can go and get a good loan, if the market quits steering and making discriminatory loans.

Those are not the people that I am worried about in this bill. These are the people who have no other resort and end up in bankruptcy as the only resort. Ms. Schwartz is not going to be able to solve their problems. She is not going to sit here and tell us, with a straight face or not with a straight face, that she can solve every one of these problems in HOPE NOW.

HOPE NOW is a wonderful program for people who can afford to refinance, reorganize, but some time at the end of the day, there are going to be some people who can't afford to do that. And what are we going to do about those?

Mr. CANNON. I ask unanimous consent that the gentleman be granted an additional minute, because I want to ask a question, Congressman. [Laughter.]

Mr. JOHNSON. Let Ms. Schwartz answer that question first, and then you ask permission granted without consent.

Ms. SCHWARTZ. For the record, HOPE NOW has been around for 3 months, and in the last 30 days, we brought on almost 10 more servicers.

Mr. WATT. That is fine, but you know, you can bring on 500 servicers, but there are still at the end of the day, some people who you are not going to be able to help. Isn't that right?

Ms. SCHWARTZ. Absolutely.

Mr. WATT. Okay. That is the only point I am trying to make.

Ms. SCHWARTZ. But we can help hundreds of thousands of borrowers——

Mr. WATT. And we want you to do that.

Ms. SCHWARTZ [continuing]. A quarter, and that is what we are talking about——

Mr. WATT. Which is why I am saying one of the solutions might be to say, if somebody comes to bankruptcy, "Okay, have you gone to HOPE NOW and exhausted every remedy you can? Is this your only resort?"—because I don't people to declare bankruptcy, unless they have exhausted every other option that they have.

Ms. SCHWARTZ. And HOPE NOW is——

Mr. WATT. And I have invited the industry to tell me how we can structure this so that only the people who are using it as a last resort are the beneficiaries of it. And there has been deafening silence——

Mr. CANNON. Would the gentleman——

Mr. WATT [continuing]. And there continues to be deafening silence from everybody except Mr. Cannon.

Mr. JOHNSON. The time has expired.

Mr. CANNON. I ask unanimous consent that the gentleman be granted one additional minute, because I just want to——

Mr. WATT. I yield that minute to you.

Mr. CANNON. I actually am trying to figure out who it is you want to help, because those people who have been steered to subprime loans who can now get prime loans are not people that you are concerned about. They can do it.

Mr. WATT. They will go into Ms. Schwartz's program.

Mr. CANNON. Are you concerned about the people who paid too much for their home? They have overpaid. The market is not going to sustain that price, and so they need to be able to go to bankruptcy to lower that price, to lower that mortgage amount?

Mr. WATT. That is part of the group.

Mr. CANNON. Okay.

Mr. WATT. And maybe they will solve some of those problems in Ms. Schwartz's deal. But somebody at the end of the day Ms. Schwartz is not going to be able to help.

Mr. CANNON. I am not sure how big that group is, but if you focus on that relatively small group, you will have this broad market effect, which means 20 percent down, and I think there is some agreement. Maybe it is only——

Mr. WATT. No, you don't believe that, Chris.

Mr. CANNON. I believe that if you get——

Mr. WATT. If you all believe that——

Mr. CANNON. If you——

Mr. WATT. You are not going to have that broad market effect. If you get that little group of people who have no other resort other than to go and appear in bankruptcy——

Mr. JOHNSON. Okay. I am losing control of this hearing——

Mr. WATT [continuing]. It is going to have a point and a half worth of impact on the whole market? That is ridiculous.

Mr. JOHNSON. Okay, we have had good discussion here.

Mr. CANNON. One more comment.

Mr. JOHNSON. Mr. Cannon, go ahead and make your comment.

Mr. CANNON. Mr. Watt, if you can come up with an identification of the group, I would be happy to work with you on that. Then you won't have the broad market effect, if it is a very, very narrow group. And I think that is what you have been saying you have tried to work on.

Mr. WATT. That is what I have been saying.

Mr. CANNON. We will talk about that and see if we can't come up with it.

Mr. WATT. That is what I have been saying.

Mr. CANNON. I don't think we can do it.

Mr. WATT. I will limit the number to just the people who really need it.

Mr. DODDS. The other issue is that you have already compromised this, so this only affects current loans. None of this cramdown will affect anyone in the future, so I think——

Mr. CANNON. You have 7 years in the current bill. That is the problem with that.

Mr. DODDS. Exactly. But it is going to end, if it passes. So you are not going to talk about the future market. I think that is the compromise that has already been put together to prevent from occurring that you are talking about. I am not sure where this giant increase in down payments is going to come from in a bill that is only for retroactive subprime mortgages, which I think the market itself is taking us out of the subprime fiasco. Nobody is doing subprimes today, so that to me seems to be an answer to the problem also.

Mr. JOHNSON. Okay. We will now go to Mr. Keller from Florida.

Mr. KELLER. Thank you, Mr. Chairman. Those who are deafeningly silent wish to speak. And I have tried to get at one side of the case through Mr. Kittle, and I am going to go to the other side.

And the gist that I got from you, Mr. Kittle, before I move on, is you believe that HOPE NOW, FHA Secure and FHA Modernization are the best way to help this troubled subprime crisis, because if we allow the courts to rewrite these home mortgages, then it would result in future first time homeowners having to pay higher down payments, higher interest rates and higher closing costs. Is that a correct summary?

Mr. KITTLE. That is correct. Along with higher loan limits for the GSEs.

Mr. KELLER. Okay. Thank you.

I am going to turn to the other side, and I am going to tell you whom I am going to talk to—Mr. Carr and Dr. Zandi. So you all listen to this, if you would.

So, Dr. Zandi, let me start with you. What do you think of the concerns raised by Mr. Kittle that this could possibly lead to higher down payments of as much as 20 percent, higher interest rates going up as much as 1.5 percent and higher closing costs as much as one or two points? Is that a concern of yours? Or do you think those figures aren't going to happen?

Mr. ZANDI. I don't think they are going to happen, no.

Mr. KELLER. And why is that?

Mr. ZANDI. Well, for a few reasons. First, I believe the cost of foreclosure is measurably greater than the cost of bankruptcy. Those economic benefits will accrue to somebody, borrowers and lenders.

Mr. KELLER. If you don't believe that those figures will happen, do you believe there is a concern, albeit now 20 percent of some risk of higher down payment?

Mr. ZANDI. No, I don't think there will be—not under the current legislation.

Mr. KELLER. And are you concerned that there might not be an interest rate increase of 1.5 percent, but some interest rate increase?

Mr. ZANDI. No, I don't think there will be a measurable increase. I don't think there will be a measurable increase.

Mr. KELLER. Are you concerned, maybe not an increase of two points for closing costs, but some increase in closing costs?

Mr. ZANDI. No, I don't think the costs will rise. I do not.

Mr. KELLER. Mr. Carr, the same questions to you. Do you have concerns about the possibility of higher down payments, interests rates or closing costs, if this bill were to pass?

Mr. CARR. Not at all. I don't believe that they would be significant. I think they would be modest. But I would point out, and ask Mr. Kittle to excuse me if I am attributing the wrong organization, but I thought it was a remarkable statistic I read recently that showed 40 percent of the foreclosures in the third quarter were actually loan mods, which means those mods are not sustainable.

Mr. KELLER. Okay. And we will let you all deal with that later. I just have a limited amount of time. The gist of what I got from you, Mr. Carr, earlier is the challenge is not that this is a purely voluntary program with all these entities participating in HOPE NOW. The challenge is even when they do participate, the relief is inadequate, that further relief is needed through this bankruptcy cramdown provision. Is that correct?

Mr. CARR. That is correct, for the voluntary programs—not FHA Secure, because that is a refinance.

Mr. KELLER. Okay.

Now, Dr. Zandi, reading your testimony, you estimate that about two million people could lose their homes and that this legislation will benefit about a quarter of those, 570,000 people. What about the remaining three-quarters? How will they seek to remedy their troubling situation of facing foreclosure, if this bankruptcy cramdown legislation is not going to be their result?

Mr. ZANDI. I think no matter what we do, there will be many, many foreclosures. I think, given the stunning decline in housing values, which are only accelerating, given the weakening job market, given the ARM resetting, given the deep recessions in places where people are losing homes——

Mr. KELLER. Don't you think many of those would in fact benefit from things like HOPE NOW and FHA Secure and FHA Modernization?

Mr. ZANDI. Absolutely. Absolutely. I am very supportive of those ideas. I think they are all very good ideas. I think they are too small, and they are not going to be effective enough. And I think that the proof is in your data right in front of you. You can see it. It is not going to work sufficiently.

Mr. KELLER. Okay.

Mr. Kittle, you have heard from two well-respected people. They are not concerned about the down payments going up or the interest rates going up or the closing costs going up. Do you have a rebuttal as to why you think they should be concerned, but aren't?

Mr. KITTLE. Well, the precedent has been set in 1978 with investment properties. I mean, that is something that is there. It has been there. Those costs on those loans have gone up.

If you talk about one of the comments that were made that this is retroactive, fear is what is driving the stock market right now. Fear is what is driving our economy. It is fear with our servicers and lenders and our members that Congress will come back the next time and when it won't. So fear is driving——

Mr. KELLER. Even if it is 100 percent concrete retroactive, the market may say, "Heck, Congress could come in and bail these folks out just like they did in the past. I am not going to make this loan at a competitive rate." Is that what you are saying?

Mr. KITTLE. Generally, with all due respect, once Congress starts, they don't stop.

Mr. KELLER. Dr. Zandi, your response.

Mr. ZANDI. Two responses. First, with regard to the investor property, the difference in interest rates is a point and a half between investor property and single family occupied homes. That point and a half is due to the much higher credit risk involved. If you give money to an investor, there is a much higher probability of default. You need to be compensated for it.

It has nothing to do with cramdowns. It has to do with the higher probability of default. So I don't think that point and a half has anything to do with these differences in cramdown legislation.

Mr. KELLER. Okay. I would love to keep going. I have got more questions, but my time has expired, so I will yield back.

Mr. JOHNSON. Thank you, Mr. Keller.

Mr. Kittle, what is most expensive to the lender? Would it be a foreclosure, or would it be a bankruptcy under the Conyers-Chabot compromise bill?

Mr. KITTLE. Well, we haven't seen anything go through under the compromise, and I know that the average cost of a foreclosure is around $30,00 to $40,000 to the lender. We are talking about long-term damage to the lender, something that is not even there yet.

Mr. JOHNSON. And in addition to those expenses to the lender, you would have the loss of the property to the borrower, the effect on the surrounding community of vacant homes, which then contribute to a loss of property tax revenue——

Mr. KITTLE. That all depends on when a customer and a letter get together——

Mr. JOHNSON. We have crime.

Mr. KITTLE. It depends upon at which point the customer, the borrower, and the lender start to communicate. There are many things that happen where the property—they get it done before the property is vacant.

Mr. JOHNSON. Well, given the fact that you have got so many other costs associated with a foreclosure—cost to society—but just looking at it from the lender's standpoint, $30,000 to $40,000 it costs to foreclose, doesn't it seem that it would be cheaper to allow a bankruptcy court to adjust the interest rate and the payoff on a loan down to reflect market value, and then the borrower is able, since he or she is in Chapter 13, to repay the mortgage and at some point come out of bankruptcy?

Doesn't it make sense that you would have that option on the table as one of the tools in the toolbox, as Congressman Watt suggested?

Mr. KITTLE. No, sir, it doesn't. It may be easier and quicker, but the cost long term is much greater for future home borrowers to the lenders. They will lose their loss of credit enhancements. FHA by itself—right now there is a statute in place that doesn't even allow cramdowns, so if cramdowns go through forward, that portion's cramdown goes directly back to the servicer on every FHA loan. My members, should this happen, will no longer want to participate in the purchase and origination of the FHA loans, which are for first time homebuyers——

Mr. WATT. Will the gentleman yield?

Mr. KITTLE [continuing]. Honest people out of this type of situation.

Mr. JOHNSON. Mr. Zandi, how would you respond to that?

Mr. ZANDI. I just want to respond to the point about FHA and the enhancement. If you look at the 2006 HOMDET data and look at those loans, those FHA loans, that would be classified as subprime under this legislation, 300 basis points over prevailing market rates, that would encompass less than 2 percent of all the FHA first purchase loans and just about a little over 3 percent—3.1 percent—of refinancings.

So the universe we are talking about here is very, very small.

Mr. KITTLE. May I respond to that, please?

Mr. JOHNSON. I will yield to Mr. Watt.

Mr. KITTLE. I would like to respond just to what he just said, because the data that he just said is inaccurate, if I may.

Mr. WATT. You all are arguing about data. We are trying to find the solution.

Mr. KITTLE. Well, this is the solution. FHA——

Mr. WATT. I don't think this the solution at all on this issue. This is about whether this is a more viable solution than foreclosure for somebody as a last resort. Now, the question that——

Mr. KITTLE. Part of your stimulus package is FHA reform.

Mr. WATT. No, I am not talking about stimulus package. I am talking about somebody who is having their house foreclosed. They aren't going to get $300 in the stimulus package. They aren't going to get any of that. I mean, this isn't about a stimulus package to me. This is about saving somebody's house.

Mr. JOHNSON. Reclaiming my time. [Laughter.]

Mr. WATT. Can I just make the point that I wanted him to address that was related to this? In most states—North Carolina is one of them—there is no such thing as a deficiency, so you foreclose and you sell. You can't get anymore than the cramdown value of the house. Usually, it is going to be a lot less than the cramdown value of the house, because some opportunist is out there, the only person that is going to buy, and the point I am making is that the cramdown figure is going to be higher than your foreclosure sale figure.

Mr. JOHNSON. And the time having expired——

Mr. WATT. I ask unanimous consent the gentleman be given two additional minutes——

Mr. JOHNSON. Thank you for——

Mr. WATT [continuing]. At least one of them——

Mr. JOHNSON. Without objection.

Mr. WATT [continuing]. Let Mr. Kittle respond, because I don't see how you think this is going to be more advantageous. Foreclosure is going to be more advantageous—work out far more advantageous. If you can work it out, it is great. But foreclosure is not a better alternative than this bill will provide to you in bankruptcy in most cases. Do you think so?

Mr. KITTLE. My time? To answer your question, I am not only concerned, but I am concerned, about the people whom you are talking about. And if you could identify that small number, like Mr. Cannon asked, that would be great. We would try to address it, both HOPE NOW and as an industry in MBA.

But I am concerned about the long-term effect of a short-term solution for your constituents being able to purchase homes down the road. It is a postponed.

Mr. WATT. Mr. Kittle, I think you are being disingenuous——

Mr. KITTLE. Not at all.

Mr. WATT [continuing]. Because the truth of the matter is the long-term implication of your selling in foreclosure at a figure that you can't even begin to approach as the cramdown figure is a lot more devastating to the industry and a lender than the cramdown figure is going to be.

Mr. KITTLE. Well, I——

Mr. WATT. And you can't convince me otherwise. I think you are being disingenuous with us now.

Mr. KITTLE. Well, I am not being disingenuous, Mr. Watt. I gave you figures in my testimony earlier, both written and stated, of what we thought the cost of the cramdown would be. We stand by those figures. We have precedence for those figures.

Mr. JOHNSON. Reclaiming my time.

Mr. Henderson, did you have something you wanted to add?

Mr. HENDERSON. Yes, sir. I think, Mr. Chair, both you and Congressman Watt have framed the issue appropriately, which is to say whether foreclosure is a more costly result than the result that

would be accomplished by this modest interjection in the market that this bill represents.

And again, when you total, as you suggested, not just the cost to the individual borrower, who loses his or her home, but the surrounding neighborhood, the impact on the community in which the foreclosure occurs, the potential for increase in crime, the other debilitating effects that this kind of widespread housing dislocation has on these neighborhoods, it is not incalculable, but it is obviously much more substantial than we have talked about here.

And it does seem to me that the effort on the part of Congressman Watt to try to define the population of people who would most be affected by this bill and who would benefit is the way to go.

I can't explain to you why you have had difficulty in getting cooperation from the industry to identify that population, but I can say that the effort to drive the industry to coordinate a more effective response in loan modification, as we have seen through the Hope Six program—we certainly support these things.

These are all necessary elements to have on the table, but they are necessary, but insufficient, to meet the magnitude of the problem. And that is why this adjustment, which is only for a period of 7 years and only applies to existing loans, is a modest intervention that we think is timely and suited to the magnitude of the problem.

Mr. JOHNSON. All right. Thank you, Mr. Henderson.

My time has expired, and I would like to thank all of the witnesses for their testimony today.

Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer as promptly as you can, to be made a part of the record. Without objection, the record will remain open for 5 legislative days for the submission of other additional information and materials.

Again, I thank everyone for their time and patience. This hearing of the Subcommittee of the Commercial and Administrative Law is adjourned.

[Whereupon, at 4:36 p.m., the Subcommittee was adjourned.]

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