

Experts Support Judicial Loan Modification

CRL Policy Brief

December 12, 2008
Updated January 6, 2009

Jack Kemp, a former Republican secretary of Housing and Urban Development, in an LA Times editorial, said: “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.”¹

Lewis Ranieri, founder of Hyperion Equity Funds and generally considered the father of the securitized mortgage market, noted that such relief is the only way to break through the problem posed by second mortgages. In a recent speech, he said that for this reason, even though he was the one “who wrote the bankruptcy exemption for first mortgages,” he “finally gave up” and now publicly supports permitting bankruptcy courts to modify mortgages on the primary residence.²

Mark Zandi, co-founder and Chief Economist of Moody's Economy.com, testifying in support of court supervised loan modifications, stated that, “giv[ing] 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.”³

Robert J. Shiller, Professor of Economics and Finance at Yale University and a principal in creating the Standard & Poor's Case-Shiller® Home Price Index, supports a change in bankruptcy law because “it will enable the courts to adjust mortgage terms to make it possible for homeowners who are experiencing difficulties making mortgage payments so that they can continue to stay in their homes.”⁴

Lawrence Summers, Director of the National Economic Council, supports amending the Bankruptcy Code to permit the modification of home mortgages, noting that, “there has been an adequate supply of capital and ability to securitize in the market for vacation and rental housing, where debtors are protected [i.e., able to modify their mortgages in bankruptcy]; and moreover, chapter 12 of the bankruptcy code enacted in the mid-1980s, which applied these principles to family farms, helped to resolve great financial distress without long-term costs in terms of reduced farm lending - despite protestations much like those that are heard today.”⁵

Professor Adam J. Levitin of Georgetown University Law Center recently published a study that examined the potential impact of modification of home mortgages on interest rates and concluded that “**permitting unlimited strip-down would have no or little effect overall on mortgage interest rates.**”⁶

United States Bankruptcy Judge J. Rich Leonard recommends that bankruptcy judges be given the authority to modify residential mortgages stating, “reamortizing and restructuring secured debt is the heart and soul of the bankruptcy process. I do it daily with factories, farms, boats, motor vehicles, vacation homes, investment property – any debt but that secured solely by the principal residence.”⁷

Professor Neil E. Harl, an agricultural economist at Iowa State University, noted the similarities between the current crisis and the farm crises of the 1980s. In response to the latter, Congress created Chapter 12 of the Bankruptcy Code to allow family farmers to modify the mortgages on the family home and farm. The relief provided by Chapter 12 is far broader than current proposals. Nevertheless, Professor Harl found that, “the Chapter 12 provisions **did not have a significant effect on interest rates** (contrary to the arguments by lenders at the time) and did not have a significant negative effect otherwise.”⁸

Professor Susan Schneider, an expert in agricultural law and farm finance and bankruptcy, noted that the concerns raised in opposition to lifting the ban on judicial modifications also were raised in opposition to Chapter 12 during the farm crisis. Yet, “[t]he concerns raised in opposition to Chapter 12 did not materialize in any respect. The availability of credit to the agricultural sector has increased over time, not decreased. **Interest rates did not increase** because of the availability of Chapter 12. Instead, like other loans they have consistently reflected over-all market conditions.”⁹

Richard Levin, Vice Chair of the National Bankruptcy Conference, testified before the House Judiciary Committee last year that, if claims like the MBA’s here were true, “the converse also would be true—tightening bankruptcy laws against families and consumers should reduce the price of credit and increase its availability. Yet there is no evidence that the adoption of the 2005 Amendments [to the Bankruptcy Code] did anything to reduce the price or increase the availability of credit.”¹⁰

Commercial Law League of America, a group that represents creditors, wrote in support of mortgage modification in bankruptcy: “modification of the loan to the collateral’s value in bankruptcy will result in greater returns for the lender as success of the debtor is much more likely and price stabilization is promoted. Therefore we believe it is in the creditor’s best interest to allow modification of residential mortgages in bankruptcy.”¹¹

Other experts supported lifting the ban on judicial modifications. Also supporting the change in the bankruptcy law are **William Apgar**, Senior Scholar at Harvard’s Joint Center for Housing Studies, a former FHA Commissioner; **Karl E. Case**, a highly respected Professor of Economics at Wellesley College; **Robert Reich**, former Secretary of Labor; and **Paul Krugman** and **Joseph Stiglitz**, both Nobel Prize-winning economists. The **New York Times**, **USA Today** and other editorial boards support it as well.

About the Center for Responsible Lending

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation’s largest community development financial institutions.

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¹ Jack Kemp, *Bringing Bankruptcy Home*, Los Angeles Times (January 18, 2008),

<http://www.latimes.com/news/opinion/la-oe-kemp18jan18,0,2977830.story?coll=la-opinion-righttrail>.

² Lewis S. Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design, Oct. 1, 2008, available at http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov (last visited Nov. 13, 2008). Ranieri is CEO of Ranieri & Co. Inc.

³ Testimony Before the Senate Committee on the Judiciary, Hearing on "The Looming Foreclosure Crisis: How To Help Families Save Their Homes" (Dec. 5, 2007).

⁴ October 29, 2007 Letter to Senators Leahy, Specter, Durbin, and Schumer from Robert J. Shiller, Stanley B. Resor Professor of Economics and Professor of Finance at Yale University, Research Associate at the National Bureau of Economic Research, and Chief Economist and co-founder of MacroMarkets LLC.

⁵ Lawrence Summers, "Prevent US foreclosures," Financial Times (Feb. 24, 2008)

⁶ Adam J. Levitin & Joshua Goodman, "The Effect of Bankruptcy Strip-Down on Mortgage Interest Rates," Georgetown University Law Center, Business, Economics and Regulatory Policy Working Paper Series, Research Paper No. 1087816 (Feb. 6, 2008) at 41 (The authors studied both historical data (relating to a period in which some courts believed that home mortgages could be modified in bankruptcy, and comparing mortgage rates in those jurisdictions that permitted modification with those that did not), and current data, including mortgage rates for vacation homes, investor properties multi-family buildings, and family farms, all of which can be modified in bankruptcy.).

⁷ April 28, 2008 Letter to Congressmen John Conyers, Jr. and Lamar S. Smith from J. Rich Leonard, U.S. Bankruptcy Judge for the Eastern District of North Carolina.

⁸ Feb. 25, 2008 Letter to Members of the U.S. Senate From Professor Neil E. Harl, Distinguished Professor In Agriculture and Emeritus Professor of Economics, Iowa State University (emphasis supplied). Professor Harl was deeply involved in efforts to address farm debt crisis of the 1980s, and wrote a book on the proposals and their consequences (*The Farm Debt Crisis of the 1980s*, Iowa State University Press, 1990). He was also the principal investigator for two research studies on Chapter 12 Bankruptcy: Faiferlick and Harl, "The Chapter 12 Bankruptcy Experience in Iowa," 9 *J. of Agr. Tax'n & Law* 302-336 (1988); and Hippen and Harl, "The Experience of Chapter 12 Bankruptcy Filers in Iowa," Iowa Agriculture and Home Economics Experiment Station, Iowa State University, Nov., 1995, 53 pp. Professor Harl notes further that, "It is critically important to recognize that both in the 1980s in the agricultural sector, and in 2007-2008 in the housing sector, the losses have already occurred because the borrowers who receive relief would otherwise have been unable to pay their loans."

⁹ Feb. 24, 2008 Letter to Senators Blanche Lincoln and Mark Pryor from Professor Susan A. Schneider, University of Arkansas School of Law.

¹⁰ <http://judiciary.house.gov/media/pdfs/Levin071030.pdf> at 7-8.

¹¹ October 31, 2008 letter to Senator Dodd from David R. Gamache, President of the Commercial Law League of America, et al.