Foreclosure Prevention Act of 2008 (S 2636)
Compromise Bill Permits Court-Supervised Modifications, Would Save 600,000 Homes

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The subprime crisis is severe and will get worse.

Recent industry projections are that half of fourth quarter 2006 securitized subprime loans will end up with the families losing their homes to foreclosure; analysts anticipate that two million American families will lose their homes over the next two years; and 40 million of their neighbors will see their home values decline due to projected foreclosures.[1] Delays in reaching an effective solution are therefore extremely costly for the families involved – and their communities, as approximately 20,000 families lose their home every week.

Very few homeowners who cannot pay their mortgages will be able to sell or refinance. Loan servicers who could modify loans to make them more affordable aren't doing so in sufficient numbers: A recent report by Moody's found that loan servicers had only modified 3.5 percent of mortgages that increased to higher rates.[2] Unless Congress takes action quickly, these families lose homeownership, surrounding neighborhoods lose property value, and the entire economy suffers.

Current law excludes homeowners from relief available to yacht owners and subprime lenders.

Today homeowners are denied equal access to bankruptcy protections. Court-supervised modification of loans is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century, but is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in chapter 13 payment plans.

Title IV of S 2636 would be effective and cost the Treasury nothing.

Legislation is urgently needed that would allow lenders and loan servicers to modify mortgages to allow families to continue paying on their loans and keep their home. S 2636 would provide judges the authority to modify harmful mortgages marketed by subprime lenders in recent years, and would help more than 600,000 families stuck in bad loans keep their homes.[3]

Mindful of the urgent need to pass legislation that will bring prompt relief to stop the cycle of decline in the housing market, the sponsors of S 2636 have prepared a compromise that narrows the bill substantially in order to address any concerns that could reasonably be raised. Specifically, the compromise bill would do the following:

- Relief available only when family lacks sufficient income to pay their mortgage. It ensures that loan modifications are available only where the homeowner's income is insufficient, after deducting for modest IRS-approved living expenses, to cover the mortgage payments. In addition, there is a good faith requirement that allows courts to exclude anyone who wrongly makes it through existing hurdles. The result of these requirements is that judicial modification will only be available for those loans that would otherwise end in foreclosure. In foreclosure, the lender cannot recover any more than the market value of the home, and typically recovers far less after a one- to two-year process.

- Lender has ability to voluntarily modify and avoid court-supervised modification. The recent American Securitization Forum fast-track modification process enables lenders to modify loans in borrowers' favor without borrower consent. If servicers choose to modify loans sufficiently, the borrower would be able to pay the mortgage, would therefore fail the IRS "means test," and would thus be ineligible for court-supervised modification.

- Relief available for existing loans only. Applying these changes prospectively would have no negative impact on interest rates – this is because bankruptcy modification would be available only where the home would otherwise be lost to foreclosure, and the risk of foreclosure is already factored into interest rates. However, the compromise goes further, and limits the bill's application to existing loans only. New loans would not be subject to bankruptcy modification. This removes any concerns that could reasonably be raised about the bill's impact on the cost or availability of credit.

- Share in appreciation. Where the modification entails marking the loan's principal amount that is secured down to the fair market value of the property, allow the lender/investor to recapture appreciation up to that amount if the home is sold before completion of the usually 5 year plan.

- Judicial discretion limited; favorable loan terms guaranteed. The compromise bill would require courts to set interest rates at a commercially reasonable, market rate – the current 30-year conventional fixed rate plus a reasonable "risk premium." The bill provides that the principal balance cannot be reduced below the value of the property, and that the term of 30 year loans will be unchanged. It also makes relief available only to those families who have sufficient income to afford their loans as modified.

- Bill applies only to loan products federal regulators deem potentially dangerous. Even as to existing loans that will otherwise end in foreclosure, the compromise bill applies only to those that fall within one of the two categories of loans that the federal regulators have determined to be potentially dangerous given recent poor underwriting by many lenders: subprime, and "non-traditional" loans (that is, interest-only loans and payment option ARMs). Conventional fixed-rate or adjustable-rate loans are not eligible.

The Benefits

- No cost the U.S. Treasury.
- Narrowly targets families who would otherwise lose their homes, and excludes families who do not need assistance.
- Helps maintain property values for families who live near homes at risk of foreclosure. Saves American families not facing foreclosure $72.5 billion in wealth by avoiding 600,000 foreclosures by their neighbors.[4]

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.

For additional information, please visit our website at **www.responsiblelending.org**.
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1 Glenn Costello, Update on U.S. RMBS: Performance, Expectations, Criteria, Fitch Ratings, p. 18; Moody's Economy.com, http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; Center for Responsible Lending, Suprime Spillover, http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

2 Aashish Marfatia, Moody's Investors Service, Structured Finance Special Report, US Subprime Market Update: November 2007, (Dec. 17, 2007) at 2.

3 Calculations by the CRL using data from its "Losing Ground" report cited above, research from the University of North Carolina, the Home Mortgage Disclosure Act, and Bloomberg research; http://www.responsiblelending.org/pdfs/stein-statement-to-senate-judiciary-looming-foreclosure-crisis.pdf, Appendix A . Mark Zandi, chief economist of Moody's Economy.com, similarly concludes that the legislation would save the homes of 570,000 families. http://judiciary.senate.gov/testimony.cfm?id=3046&wit_id=6807

4 Families lose 1.14% of their own house's value for every foreclosure that occurs on their block. Woodstock Institute, "There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values," June 2005, http://www.woodstockinst.org/content/view/104/47/. Median house value of $212,000 * 1.14% * 50 houses/block = $121,000 cost/foreclosure * 600,000 avoided = $72.5 billion saved. http://www.realtor.org/Research.nsf/files/MSAPRICESF.pdf/$FILE/MSAPRICESF.pdf