Permitting Judicial Modification of Home Loans Would Save 600,000 Homes – Purchase of Securities Will Not Save Any

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Proposed financial bailout bill will not help people save their homes

The government proposes to purchase hundreds of billions of dollars of illiquid mortgage-related assets as a response to this country's financial crisis. The vast majority of these assets are securities issued privately through Wall Street that are backed by subprime or Alt A home loans, meaning that the government will own only a portion of these individual home loans. As such, the government will have **no** ability to modify the underlying loans; there will be dozens of other owners scattered around the globe who would need to consent to such a modification. Further, in roughly half the cases there will be a piggyback second mortgage, which will also stand in the way of a modification. Simply owning securities gives the government no right greater than they currently hold to help borrowers stay in their homes.

The subprime crisis is severe and will get worse.

The underlying problem causing the crisis that the proposal is meant to address is too many families are unable to pay their loan, which causes massive foreclosures, which causes further home price declines, which causes financial institutions to go under and more families to lose their homes. The proposed bill will do nothing to address this fundamental problem.

Recent industry projections are that <u>half</u> of fourth quarter 2006 securitized subprime loans will end up with the families losing their homes to foreclosure; 2 million American families are anticipated to lose their homes over the next two years; and 40 million of their neighbors will see their home values decline due to projected foreclosures. 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. And the crisis of Alt A foreclosures has begun; while they constitute 10% of Fannie Mae and Freddie Mac's exposure, they are causing half of their losses.

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: 70% of troubled borrowers are on track to receive no help from their servicers. 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. Judicial 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 <u>not</u> permitted to modify in chapter 13 payment plans.

Judicial modification 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. Judicial modification 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.

- 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. Servicers hold the keys to the courthouse. If the servicer agrees to a sustainable modification, the borrower will not qualify for bankruptcy relief because they will fail the eligibility means test. The American Securitization Forum fast-track modification process enables lenders to modify loans in borrowers' favor without borrower consent. Further, there would be no threat of investor lawsuits because alternative to modification would be worse.

- Judicial discretion limited; favorable loan terms guaranteed. The 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 cannot exceed 40 years. It also makes relief available only to those families who have sufficient income to afford their loans as modified.

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 $89 billion in wealth by avoiding 600,000 foreclosures by their neighbors.
- Complements programs that rely on voluntary loan modifications or servicer agreement to refinance for less than the full outstanding loan balance. Voluntary modifications and refinances are the goal. Judicial loan modification would induce more voluntary modifications outside bankruptcy because everyone would know the alternative, just as occurred under Chapter 12, which was passed to modify loans on family farms in the late 1980's.

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**.
Eric Stein and Ellen Harnick, 919/956-4400.