Testimony of Julia Gordon, Center for Responsible Lending
Before the U.S. House of Representatives
Committee on Oversight and Government Reform
Subcommittee on Domestic Policy

"Foreclosures Continue: What Needs to Change in the Government Response?"

February 25, 2010

Good morning Chairman Kucinich, Ranking Member Jordan, and members of the committee, and thank you for the invitation to discuss the Administration's response to the foreclosure crisis.

As you know, we are now facing historic levels of homes lost through foreclosures. Not every individual foreclosure can or should be stopped, but there is an urgent need to stop the epidemic by closing the growing chasm between prevention and losses. Without stronger policy intervention, not only will millions of families lose their homes unnecessarily, but massive foreclosures will continue to destroy communities, drag down the housing market, and keep a full economic recovery out of reach.

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable mortgages. In total, Self-Help has provided over $5.65 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

The downturns in the housing market and economy are impacting Self-Help as well as other lenders. As a result, Self-Help is grappling with many of the same issues encountered by other lenders, including servicer capacity limitations and homeowners who face foreclosure and other economic challenges. Our testimony today is informed by this experience.

Reckless and abusive lending practices created a nationwide foreclosure crisis that has had catastrophic consequences for families, communities—especially communities of color—and the overall economy. Historically, the housing sector has led the way out of economic downturns.[1] Continued weakness in the housing sector will likely slow or derail economic recovery and hamper efforts to create jobs and reduce unemployment.

We are glad that the Administration has created the Making Home Affordable program to help prevent foreclosures, and we commend the effort to try to modify troubled mortgages through the modification component of MHA (HAMP). Yet there is no "silver bullet" strategy to fix every mortgage or repair every foreclosure-ravaged neighborhood. Moreover, the toxic combination of negative equity and a weak economy means that many homeowners with fixed-rate, prime mortgages are experiencing much higher default numbers as well. The breadth and depth of the housing crisis means that we must address it through multiple approaches and solutions. For HAMP to reach its potential, we must use a sufficiently broad array of tools both within HAMP and in other contexts to target different types of loans, lenders, and homeowner situations.

Here's how HAMP should be changed to improve its ability to combat default and foreclosure:

- Stop foreclosures while servicers evaluate eligibility for loan modifications or other non-foreclosure options.
- Reduce principal balances on troubled loans to ensure that loan modifications are sustainable
- Make the details of the "net present value" (NPV) evaluation model widely available to homeowners and their advocates and improve the model.
- Share loan-level data with the public to ensure that everyone has access to the most complete source of data on foreclosure prevention.
- Assist homeowners who have lost their jobs and do not have nine months of guaranteed unemployment income.
- Transfer servicing duties to companies that don't have conflicts of interest.
- Provide an independent, formal appeals process for homeowners who believe their HAMP application was not handled correctly.
- Permit homeowners who experience additional hardship to be eligible for additional HAMP modifications.
- Require that servicers let borrowers in bankruptcy use HAMP.

We also believe Congress has a crucial role to play in mitigating the crisis. Specifically, we ask Congress to take the following actions:

- Pass legislation mandating loss mitigation prior to foreclosure.
- Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined with a burdensome tax bill.
- Permit bankruptcy judges to modify mortgages on principal residences.

- Create an independent Consumer Financial Protection Agency, which can establish and monitor common-sense rules to ensure this type of crisis never happens again.
- Prohibit predatory lending, particularly unsustainable loans, yield spread premiums and prepayment penalties.

I. Background

A. Dimensions of the Foreclosure Crisis

With one in seven homeowners delinquent on their mortgage or already in foreclosure[2] and one in four mortgages underwater,[3] continued weakness in the housing sector will likely slow or derail economic recovery and hamper efforts to create jobs and reduce unemployment. According to industry analysts, the total number of foreclosures by the time this crisis abates could be anywhere between 8 and 13 million.[4] The Hope Now Alliance reports that approximately 2.1 million foreclosure sales have been completed between 2007 and November 2009.[5]

While some headlines say that housing prices are stabilizing, there is a still an enormous and growing overhang of foreclosure starts still working their way through the process. This "shadow inventory" is likely to threaten any kind of housing recovery as investors and homeowners wait for the other shoe to drop.[6] Sometimes foreclosure starts will not result in a foreclosure sale because a family will pay the arrearages and reinstate their mortgage, sell the home short, or give up the home in a deed-in-lieu of foreclosure transaction. Sometimes the family will move out because they think they are being foreclosed on, but the bank itself walks away from the foreclosure.[7] (On the other hand, the relative lack of foreclosure sales means that many homeowners can still be saved by an effective foreclosure prevention program.)

In terms of loan category, this crisis began in the subprime market and quickly spread to the Alt-A market. Delinquencies of subprime loans escalated quickly during 2007 and 2008. Although the rate of increase has begun to level off, about half of subprime loans originated during 2006 and 2007 are delinquent (see Figure 1). The picture looks similar for Alt-A loans, which are largely nontraditional loans aimed at people with better credit profiles than subprime borrowers but that contain risky features or minimal underwriting.

By the first quarter of 2009, approximately one-third of Alt-A loans originated in 2006 and 2007 were delinquent, and that rate continues to climb (see Figure 2).

Figure 1

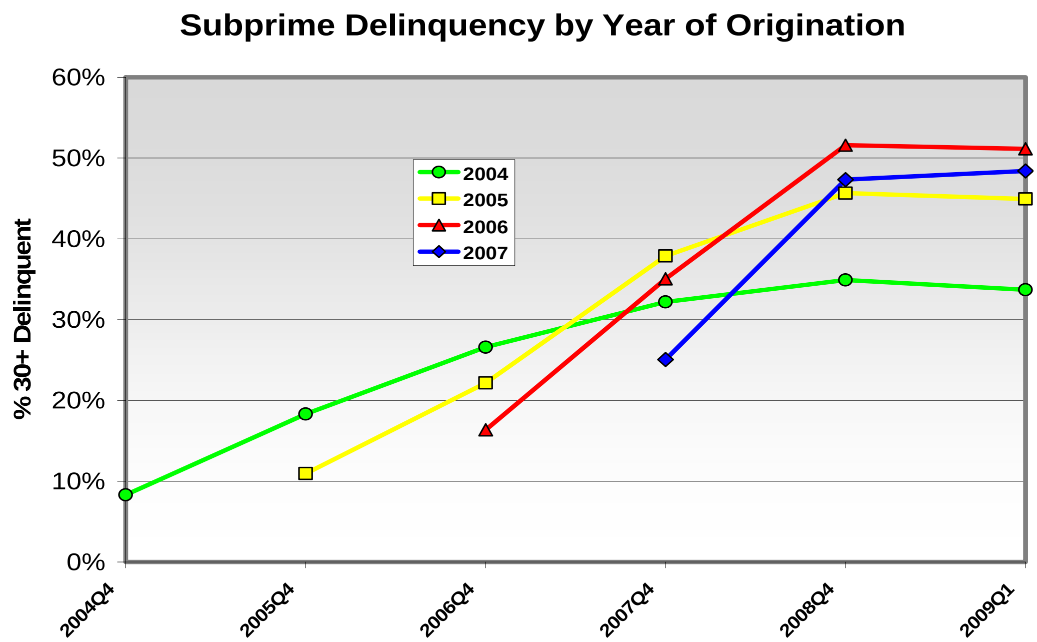
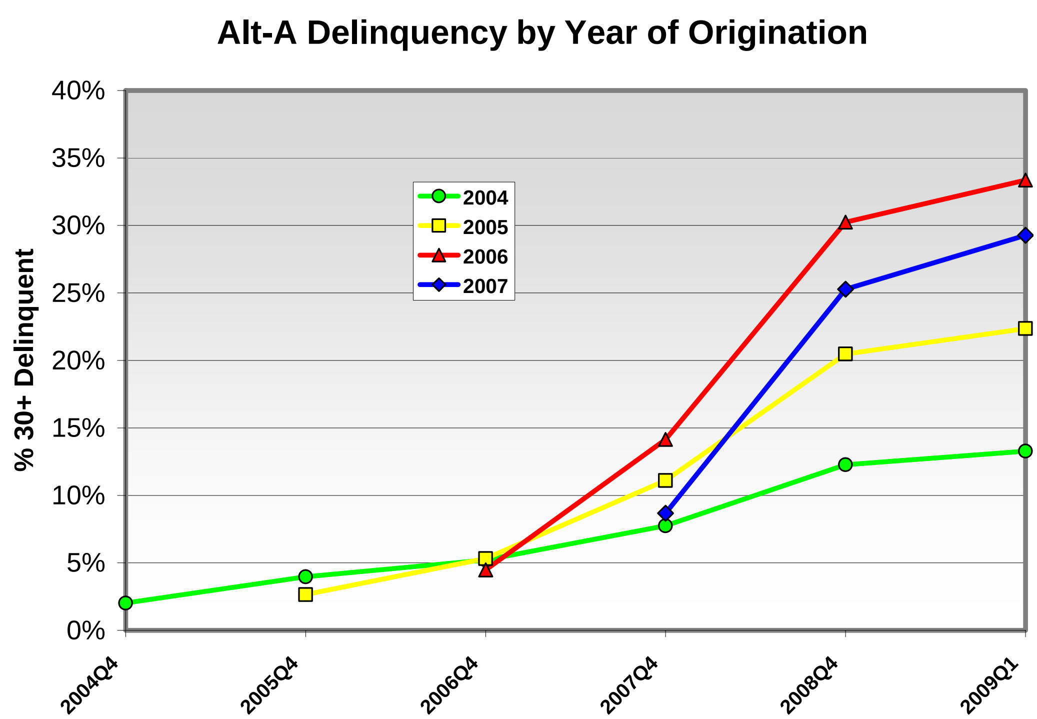


Figure 2



Source for Figures 1 and 2: *Characteristics and Performance of Nonprime Mortgages*, Government Accountability Office, (July 28, 2009)

According to a report by the OCC and OTS on the subset of mortgages serviced by the banks they regulate, during the third quarter of 2009, 16 percent of payment option ARMs (POARMs) were seriously delinquent and almost 12 percent were in the process of foreclosure.[8] Long-term projections offer little consolation: Examining the performance of privately secured loans made in 2006 and 2007, Fitch Ratings projects that more than 70 percent of POARM loans and between 40 and 54 percent of 30-year Alt-A loans will default.[9]

Although delinquencies among subprime and Alt-A loans have rightfully received much attention to date, the more traditional prime market has also been deeply affected. Over the last year, interest-only prime adjustable rate mortgages have become an increasing concern. For example, 60+ day delinquencies have doubled among such loans serving as collateral in private-label residential mortgage-backed securities and originated in 2007, growing from 9.1 percent to 18.6 percent.[10] For all prime loans, the average 60-day delinquency rate reported between 1979 and 2006 was 1.98 percent.[11]

B. Foreclosures impact the entire community through lost home value, increased demand for city servicers, and lost rental housing.

In addition to the costs to homeowners and communities, foreclosure “spillover” costs are massive. Tens of millions of households where the owners have paid their mortgages on time every month are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located near a property in foreclosure. Depending upon the geography and time period, the estimated impact of each foreclosure ranged from 0.6 percent to 1.6 percent in lost value to nearby homes. CRL estimates that the foreclosures projected to occur between 2009 and 2012 will result in $1.86 trillion in lost wealth, which represents an average loss of over $20,000 for each of the 91.5 million households affected.[12] These losses are on top of the overall loss in property value due to overall housing price declines.[13]

What’s more, foreclosures cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services because vacant homes attract crime, arson, and squatters. As property values decline further, more foreclosures occur, which only drives values down still more. The Urban Institute estimates that a single foreclosure results in an average of $19,229 in direct costs to the local government.[14]

Finally, the crisis severely impacts tenants in rental housing. According to the National Low-Income Housing Coalition, a fifth of single-family (1-4 unit) properties in foreclosure were rental properties and as many as 40 percent of families affected by foreclosure are tenants.[15] While tenants now have some legal protection against immediate eviction,[16] most of them will ultimately be forced to leave their homes.[17] Furthermore, a great deal of housing stock is now owned by the banks rather than by new owners. Banks are not in the business of renting homes and are not well suited to carry out the duties required of a landlord.

Compounding the problem of renters losing homes to foreclosures is the impact that the crisis has on other sources of affordable housing. A policy brief from the Joint Center for Housing Studies reports that dramatic changes at Freddie Mac and Fannie Mae and coincident changes in credit markets have disrupted and increased the cost of funding for the continued development of multi-family (5+ units) properties, despite the fact that underwriting and performance has fared better in this segment than in single-family housing.[18] As a result, even though a general over-supply of single-family housing persists, the deficit in the long-term supply of affordable rental housing is at risk of increasing.[19]

C. Toxic loan products lie at the heart of the mortgage meltdown.

1. The housing crisis was precipitated by risky loans, not risky borrowers.

For years, many in the mortgage industry have evaded responsibility and fended off government efforts to intervene by blaming homeowners for mortgage failures, saying that lower-income borrowers were not ready for homeownership or not able to afford it.[20] Yet empirical research shows that the elevated risk of foreclosure was an inherent feature of the defective nonprime and exotic loan products that produced this crisis.

A recent analysis by Vertical Capital Solutions found that the least risky loans[21] significantly outperformed riskier mortgages during every year that was studied (2002-2008), regardless of the prevailing economic conditions and in every one of the top 25 MSAs.[22]

That study also confirmed that loan originators frequently steered customers to loans with higher interest rates than those for which they qualified and loans loaded with risky features. It found that 30 percent of the borrowers in the sample (which included all types of loans and borrowers) could have received a safer loan. In late 2007, the Wall Street Journal reported on a study that found 61 percent of subprime loans originated in 2006 "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[23]

Even applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate subprime loans for—at most—half to eight tenths of a percent above the initial rate on the risky ARM loans they were given.[24] Even more troubling, originators particularly targeted minority communities for abusive and equity-stripping subprime loans, according to complaints and affidavits from former loan officers alleging that this pattern was not random but was intentional and racially discriminatory.[25]

CRL's own research has demonstrated that common subprime loans with terms such as adjustable rate mortgages with steep built-in payment increases and lengthy and expensive prepayment penalties presented an elevated risk of foreclosure *even after accounting for differences in borrowers' credit scores.* This research also has shown how the risk entailed in these loans had been obscured by rapid increases in home prices that had enabled many borrowers to refinance or sell as needed. The latent risk in subprime lending has been confirmed by other researchers from the public and private sectors.[26]

A complementary 2008 study from the University of North Carolina at Chapel Hill supports the conclusion that risk was inherent in the structure of the loans themselves.[27] In this study, the authors found a cumulative default rate for recent borrowers with subprime loans to be more than three times that of comparable borrowers with lower-rate loans. Furthermore, the authors were able to identify the particular features of subprime loans that led to a greater default risk. Specifically, they found that adjustable interest rates, prepayment penalties, and mortgages sold by brokers were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower-rate fixed-rate mortgage from a retail lender.

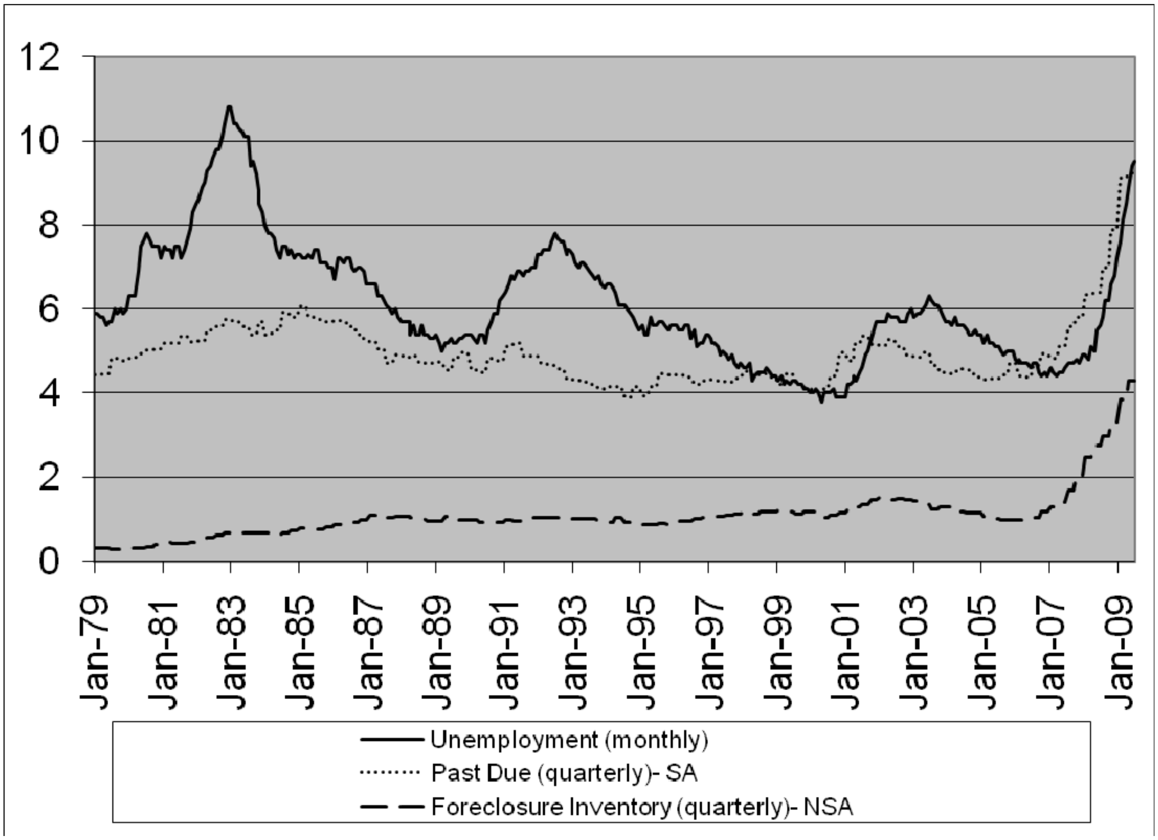
Finally, CRL conducted a more targeted study to focus on the cost differences between loans originated by independent mortgage brokers and those originated by retail lenders. In that study, we found that for subprime borrowers, broker-originated loans were consistently far more expensive than retail-originated loans, with additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[28] Even in the first four years of a mortgage, a typical subprime borrower who used a broker paid $5,222 more than a borrower with similar creditworthiness who received a loan directly from a lender.[29]

2. While high unemployment makes a bad situation worse, unemployment in and of itself is not the reason for the soaring foreclosure rate.

In light of the high unemployment rates now prevailing across the country, it is useful to examine the relationship between job loss, mortgage delinquency, and foreclosures. An effort is underway to characterize the foreclosure crisis as an economic problem that should be solved through job creation strategies rather than by helping homeowners trapped in bad loans.[30]

This characterization is inaccurate at best. Certainly unemployment or underemployment contributes significantly to the economic crisis in which many families find themselves, hurting their ability to pay mortgages as well as other debts and living expenses. But to make a difference in the foreclosure rate, we must directly address failing mortgages.

The chart below shows that during previous periods of very high unemployment, foreclosure numbers remained essentially flat. Delinquency levels did rise somewhat, but they rose far less than they have risen during the recent crisis.[31]



Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

The reason why unemployment is causing more foreclosures now is the rampant negative equity problem. In past recessions, homeownership served as a buffer against income interruptions. Homeowners facing unemployment could sell their homes or tap into their home equity to tide them over. Today, selling homes is difficult to impossible in many markets, and even when sales take place, the seller sees no net proceeds from the sale. New research shows that the risk of default due to unemployment rises mainly in situations where homeowners are underwater on their mortgage.[32]

And why are so many homeowners underwater? It is because the glut of toxic mortgages first inflated the housing bubble and then led to the bursting of the bubble, followed by a self-reinforcing downward spiral of home prices.

II. The Treasury Department, Congress, and all stakeholders should work together to stop as many foreclosures as possible and break the cycle of housing price declines and continued economic weakness.

It is imperative that we continue to try to avoid as many foreclosures as possible, even as it becomes clear that this task is much more daunting than some may have imagined. Not only does it reflect badly on us as a society that we would permit so many people to lose their homes, but the enormous costs both to homeowners and to state and local governments will continue to drag the overall economy down.[33] With no easy solution to this problem, all stakeholders must work together to come up with innovative, workable strategies that can adapt as circumstances change.

A. The HAMP program must be improved and expanded to create more loan modifications that are more sustainable to benefit both homeowners and investors.

The HAMP program just celebrated its one year anniversary.[34] Initially projected to help three to four million borrowers, HAMP works by reducing homeowner payments to an affordable level, defined as a 31% debt-to-income ratio. So far, nearly a million homeowners have received a trial modification, yet only 116,000 have received a permanent loan modification.[35] The Treasury Department's own release, while claiming that HAMP is on track to meet its goal of modifying 3-4 million loans, also shows a chart indicating that only 1.7 million borrowers are even eligible for HAMP under its current guidelines.[36]

As problematic as HAMP's inadequate performance is the widespread negative experience that so many homeowners and their advocates have had with the program. The program's effectiveness has been hampered by lack of servicer capacity, a piece-by-piece rollout of complementary programs addressing second liens and short sales, inadequate compliance review, minimal public data availability, and – perhaps most disturbingly – widespread violation of HAMP guidelines by participating servicers.

To improve the HAMP program and extend its reach, we have outlined a number of recommendations below.

1. Stop foreclosures from proceeding while servicers evaluate eligibility for loan modifications or other non-foreclosure options.

Because servicers are not barred from proceeding on a parallel track toward foreclosure while a HAMP evaluation is pending, homeowners are receiving a confusing mix of communications from their lender, some of which tell the borrowers they are being considered for HAMP, but others of which warn of an impending foreclosure sale. This mixed message may well lie at the heart of several vexing problems, including the failure of some borrowers to send in all their documentation, the early redefault of many trial modifications, and the difficulty servicers have reaching certain borrowers.

In addition, the continuation of the foreclosure process often means that the servicers' lawyers bill thousands of dollars in attorneys fees that the homeowners are then expected to pay. Servicers either demand these payments upfront (an apparent violation of HAMP) or add the costs into the loan balance. In either event, these costs make it harder to provide an affordable loan modification.

Finally, although HAMP guidelines prohibit the actual foreclosure sale from taking place prior to a HAMP evaluation, some sales are taking place anyway because the foreclosure proceedings are handled by outside law firms and communications between servicers and foreclosure attorneys regarding HAMP are extremely minimal.[37]

To alleviate the confusion and prevent inadvertent foreclosures, servicers should be barred from proceeding with any portion of a foreclosure action prior to concluding their determination of whether a borrower qualifies for a HAMP modification. In other words, they should not be permitted to institute an action, and if an action has already been instituted, they should not be permitted to move forward at all, in cases where they can reach the homeowner or the homeowner has already requested an evaluation. Guidelines should be established to clarify when the servicer can continue with foreclosure proceedings if the homeowner is unreachable.

There have recently been reports in the media that Treasury is poised to take action on this issue.[38] We strongly support any such action.

2. Reduce principal balances on troubled loans to ensure that loan modifications are sustainable.

Millions of Americans now owe more on their mortgages than their homes are worth. While the overall percentage of American mortgages that are underwater is estimated to be 24 percent,[39] we can assume that percentage is far higher for homeowners who are having trouble affording their mortgage.[40] This problem was caused by the extreme housing price declines triggered by risky lending, and in some cases is exacerbated by negative amortization of the mortgage itself, such as what happens with POARMs.

Recent research has shown a strong correlation between negative equity and mortgage delinquency.[41] Homeowners who are underwater have no cushion to absorb financial difficulties. Furthermore, in some cases, homeowners who are unlikely to move into a positive equity position have fewer incentives to stay in the home or make the necessary ongoing investments in maintenance.[42] For these homeowners, even the reduction of monthly payments to an affordable level does not fully solve the problem. As a result, a homeowner's equity position has emerged as a key predictor of loan modification redefault, more so than unemployment or other factors.[43]

Negative equity is of particular concern in the case of POARMs. Because of the negative amortization feature and because their origination was concentrated in high-cost areas, many POARMS are very deeply underwater. (The vast majority of POARM borrowers chose to make the minimum payment permitted, at least while they were still paying on their loan, meaning most of these loans were negatively amortizing even as housing prices declined.) As noted previously, POARMs are failing at a stunning rate. Unfortunately, because of the way these loans were structured, the current design of HAMP is not able to help many POARM borrowers get their payments to an affordable level. Minimum payments on these loans are so low that it is hard to restructure the loans without raising the monthly payments. What's more, many POARMs already have a 40-year term, so a term extension cannot help either. The only way to help POARM borrowers in a sustainable way is to reduce principal.[44]

Many stakeholders believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.[45] However, the OCC's Mortgage Metrics report indicates that even as loan modification activity ramps up, principal reduction is still relatively rare. One context in which it occurs is in portfolio loans with no second liens, which suggests that banks understand the usefulness of principal reduction but that for securitized loans, there is a conflict of interest. Often, that conflict is that the bank owns the second liens and investors refuse to agree to a writedown on the first lien unless the second lienholder does the same. Sometimes that conflict is between the servicer and the loan owner, because servicers derive the bulk of their income from the monthly servicing fee, which is set as a percentage of the outstanding loan principal balance in the pool, so they are less likely to write down principal even when it's in the best interest of the loan owner.[46]

In short, it is likely that the only way principal reduction is ever going to happen on a widespread basis is if it is required as part of HAMP or a program like HAMP, and if there are financial incentives for taking the writedown. (There are currently many investors with available cash who are ready and willing to buy loans and write down principal aggressively, yet it is almost impossible to get the servicer to initiate a principal reduction.)

Alternatively, loans could be removed from the control of the servicers in some way, such as by requiring servicers to pass accounts to a specialty servicer once the loan reaches a certain level of delinquency.[47] It also may be useful to consider policies that will make it easier for investors to buy loans out of pools, or consider whether the government should exercise its eminent domain authority to buy loans out of pools.[48]

So far, the only policy reason advanced for the Treasury's failure to incorporate a principal reduction into HAMP is the fear of moral hazard. Yet the actual costs of foreclosure along with the staggering associated costs[49] serve as a significant counterweight to this concern, just as the external costs outweighed the moral hazard of last year's bank bailout. But even beyond that, given the large percentage of underwater homeowners likely to default at some point,[50] moral hazard concerns should not prevent Treasury from moving forward on this front. HAMP has already built numerous safeguards into the application process, and it is would be possible to phase in the reduction over time as the homeowner continues to pay on the loan or create a shared equity component that would kick in upon sale of the home.

3. Make the details of the net present value (NPV) evaluation model widely available to homeowners and their advocates and improve the model.

A homeowner's qualification for a loan modification under HAMP is determined primarily through an analysis of the Net Present Value ("NPV") of a loan modification as compared to a foreclosure. The test measures whether the investor profits more from a loan modification or a foreclosure. The outcome of this analysis depends on inputs that include the homeowner's income, FICO score, current default status, debt-to-income ratio, and property valuation, plus factors relating to future value of the property and likely price at resale. Servicers that participate in HAMP are required to apply a specific NPV analysis model to all homeowners who are 60 days delinquent and those at imminent risk of default.

Homeowners and their advocates need access to the HAMP program's NPV model so that they can determine whether servicers have actually and accurately used the program in evaluating the homeowner's qualifications for a HAMP modification. Without access to the NPV analysis, homeowners are entirely reliant on the servicer's good faith.

Treasury has recently made some modest improvement on this front by requiring servicers to provide homeowners who are denied a HAMP modification based on the NPV calculation an opportunity to verify the information the servicer used in making the NPV calculations. This requirement should be strengthened to require servicers automatically to provide the NPV inputs and outputs to homeowners denied a HAMP modification, instead of requiring homeowners to make a request for the data.

Servicers should also be required to provide borrowers with the numerical results of the NPV calculations, rather than the mere result that modifying their loan would pass or fail the test, and they should allow borrowers to review the property valuation used in the NPV calculation, which is one of the inputs with the greatest effect on the results. Where the servicer says that the investor did not approve the modification, basic information including the investor or guarantor's name, identification of the controlling document, and a summary of efforts taken to secure investor approval for the proposed loan modification specifically and participation in HAMP generally should be provided in each relevant denial notice.

Finally, the HAMP NPV model needs to be improved. At present, it is a linear model in which the homeowner is put through a "waterfall"of ways to make a monthly payment more affordable: interest rate reduction first, term extension second, and principal forbearance (or, in rare instances, principal reduction) third. The model is only designed to permit servicers to discharge their duty to evaluate the NPV. It is not designed to maximize the chances of coming out with a positive NPV, nor is it designed to come up with the most sustainable loan modification. A more dynamic and richer model would do a better job of saving as many homes as possible in a way that makes financial sense to the loan owners.

4. **Share loan-level data with the public to ensure that everyone has access to the most complete source of data on foreclosure prevention publicly available.**

The Treasury Department is collecting a broad range of data from servicers participating in the HAMP program – more data than has ever been collected about the loan modification process by any other public entity. This data can shed great light into how the HAMP program is working: what types of borrowers are getting modifications and which are not, particularly for minority borrowers; the geography of modification activity; the types of modifications that are being provided; and the patterns of re-defaults that are occurring. However, the Treasury Department has severely limited the data it has released.

Treasury should release modification data at the individual loan level to the public as soon as possible in a raw, disaggregated form so that independent researchers and other interested parties can analyze the data themselves. This data is crucial for those working to develop more and better tools to fight foreclosures and prevent a repeat of this crisis. Public access to this data should be comparable to public access to the data collected under the provisions of the Home Mortgage Disclosure Act (HMDA) data. What's more, it is essential that this data be made available soon. While researchers appreciate the ease of working with high-quality, clean data, the urgency of the problem demands quick turnaround. If additional staffing is needed to scrub the data and turn it around quickly, we urge Treasury to assign more people to the task.

Finally, while this data must be purged of private information such as names and social security numbers, some have suggested that race and ethnicity data not be released on a servicer-by-servicer basis. Given the significant racial and ethnic inequities that have plagued the mortgage market, detailed demographic data for each servicer is of vital importance to all stakeholders.

5. Assist homeowners who have lost their jobs and do not have nine months of guaranteed unemployment income.

The latest HAMP data report shows that 57.4 percent of those seeking a HAMP modification have experienced a loss of income. The Treasury should add capacity to HAMP so that it can assist those unemployed homeowners who cannot demonstrate the nine months of unemployment benefits necessary to qualify for a HAMP modification, yet who would ultimately be successful long-term homeowners.

One idea is to create a low-cost loan fund similar to a program created by the state of Pennsylvania to provide loans to unemployed homeowners to help them pay their mortgage. Pennsylvania's Homeowners Emergency Mortgage Assistance Program (HEMAP) has provided loans to over 43,000 homeowners since 1984 at a cost to the state of $236 million. Assisted homeowners have repaid $246 million to date, which works out to a $10 million profit for the state over a 25-year period of helping families keep their houses. To be eligible for HEMAP, homeowners must be in default through no fault of their own and have a reasonable prospect of resuming their mortgage payments within 36 months. A recent paper from the Boston Federal Reserve also proposes helping homeowners who had a "significant income disruption" through bridge loans of up to 24 months.[51] The White House recently announced an initiative to provide five states with funding that could be used toward a program of this nature, but it is needed nationwide.

The Treasury Department has also indicated that it is considering a targeted forbearance program for people who have lost their jobs, but it has not yet released any details of such a program. Such a program could also provide relief to the millions of people facing a loss of income, as long as they do not continue to accrue additional fees or charges during the forbearance period.

6. Transfer servicing duties to companies that don't have conflicts of interest.

Since early 2007, mortgage loan servicers have been promising to help homeowners in trouble.[52] The Bush Administration believed that servicers would voluntarily provide this assistance because in so many cases, foreclosure made no economic sense for the lender or loan owner. Unfortunately, financial incentives for servicers often encourage outcomes that are not advantageous either for the loan owner or for the homeowner.[53] What's more, like other players in the financial services industry, much of their income comes from fee-generating tricks and traps for consumers.

It is fully understood now that helping homeowners avoid foreclosure is frequently in conflict with the financial interest of servicers. Thus, the HAMP program provides servicers with financial incentives for placing homeowners into permanent loan modifications if the benefit (net present value) of the modification is higher than that of foreclosure. Unfortunately, so far, these financial incentives have not proven sufficient for servicers to process loan modification requests in a timely, effective manner.

Moreover, most observers agree that most servicers in their current form lack the capacity to handle a foreclosure crisis of the size and scope we are seeing today.[54] Servicers have had to do a great deal of retooling. Their employees are no longer simply collection agents, but are serving essentially as both loan underwriters and housing counselors. In the early months of the program, a great deal of latitude was given to servicers for their ramp-up time, but these capacity issues continue to persist. Homeowners still have terrible trouble reaching their servicers, and when they do, they often encounter employees who know little about HAMP, who try to steer them other products or persuade them to leave their homes, and they are unable to get any firm decisions made in a timely manner.

The perceived shortcomings of the mainstream servicing industry has led to significant growth in the number and size of so-called specialty servicers – businesses that specialize in intensive, "high-touch" approaches to working with homeowners in trouble. These specialized servicers are often able to reach homeowners at many times the rate of a mainstream servicer and in many cases are more skilled in dealing with families in crisis. Recently, Fannie Mae and Freddie Mac began to require their servicers who are not producing sufficient results to use specialty servicers for the delinquent accounts.

We think it would be useful to explore how and under what circumstances the Treasury Department could require HAMP-participating servicers to turn their accounts over to special servicers working for the government when the account becomes 60 days delinquent. However, it would be of the utmost importance to ensure that the specialty servicers are carefully monitored to ensure that a more aggressive approach does not violate consumer rights with respect to debt collection.

7. Provide an independent, formal appeals process for homeowners who believe their HAMP application was not handled correctly.

As of this past January, servicers are now required to notify homeowners who are rejected for a HAMP modification promptly and with an explanation for why they have been rejected. This is a long overdue improvement, but homeowners who have been denied a loan modification or who are being foreclosed on in error still need access to an independent appeals process. Freddie Mac's compliance program aims to ensure that servicers abide by the program's guidelines, but it is not a process accessible by an individual homeowner. Treasury is allowing servicers to offer the HOPE hotline as a dispute resolution mechanism in their rejection letter to homeowners, yet as described, the HOPE hotline can only contact the servicer; it does not have any authority to enforce or monitor compliance with program requirements. Homeowners need access to an independent escalation process in addition to any internal review process they can access within the servicer.

8. Permit homeowners who experience additional hardships to be eligible for additional HAMP modifications.

Even after a homeowner is paying the monthly payments due under a HAMP loan modification, life events may still occur that would once again disrupt these payments, such as job loss, disability, or the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors money and preserve homeownership. Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further HAMP modification is punitive to homeowners already suffering a loss and does not serve the interests of investors. Some servicers provide some modifications upon redefault as part of their loss mitigation program; this approach should be standard and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

9. Require that servicers let homeowners in bankruptcy use the HAMP program.

As a result of the HAMP guidelines providing servicer discretion on whether to provide homeowners in bankruptcy access to loan modifications under the program, homeowners generally are being denied such loan modifications. The HAMP guidelines should explicitly provide that servicers must consider a homeowner seeking a modification for HAMP even if the homeowner is a debtor in a pending bankruptcy proceeding. We believe this change may also be forthcoming from Treasury, and we encourage it to be made soon.

B. In addition, Congressional action in several other areas would provide significant benefit in mitigating the crisis.

1. Pass legislation mandating loss mitigation prior to foreclosure.

Even if the HAMP program is changed to prevent the filing of foreclosure prior to evaluation, Congress should make this requirement into a legal standard with a private right of action. The fact is, while HAMP servicers do have a contract with the Treasury Department, the servicers and the Treasury are the only parties to those contracts. Even if a servicer breaches the contract, the Treasury's primary remedy is to withhold incentive payments, which by and large are not yet emerging as a strong enough incentive to change servicer behavior. It is important to give homeowners a clear right to evaluation prior to foreclosure, and for many servicers, only a legal requirement will cause them to build the systemic safeguards necessary to ensure that such evaluations occur.

In the Senate, a bill introduced by Senator Jack Reed (S. 1431) would address this problem. There is a similar legislation that was introduced in the House of Representatives last summer by Representative Maxine Waters (HR 3451), but the Waters bill needs to be extended to cover existing loans.

2. Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined with a burdensome tax bill.

Even principal forgiveness or the most carefully structured loan modifications can be seriously undermined if struggling homeowners must treat the forgiven mortgage debt as taxable income. Solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[55]

To describe the tax problem in brief, when lenders forgive any mortgage debt, whether in the context of a short sale, a deed-in-lieu-of-foreclosure, foreclosure, or principal reduction in a loan modification, that amount of forgiven debt is considered to be income to the homeowner and tax must therefore be paid on it unless the homeowner qualifies for some kind of exclusion to that tax. In 2007, Congress passed the Mortgage Forgiveness Debt Relief Act of 2007 to prevent adverse tax consequences to homeowners in trouble. After passage of this bill, most policymakers considered the problem to have been solved.

Unfortunately, because of the way that legislation was written, many homeowners still owe tax despite the Mortgage Forgiveness Debt Relief Act. That legislation defined "qualified mortgage debt" to include only that debt that was used to purchase a home or make major home improvements. In calculating the tax, any unqualified debt is first subtracted in its entirety from the amount of forgiven debt (not on a pro rate basis). In many cases, the amount of unqualified debt will equal or exceed the amount of debt forgiven, leaving the homeowner to pay tax on the entire forgiven debt – and even in those cases where the amount forgiven exceeds the amount of unqualified debt, the homeowner will still owe a large tax bill.

Expanding the definition will make it easier for everyone, even those homeowners already fully covered by the Mortgage Forgiveness Debt Relief Act, to take advantage of this exclusion. To take advantage of the mortgage debt exclusion, a homeowner now has to file a long-form 1040, along with a Form 982, a very complicated and difficult form. Unfortunately, most lower and middle income taxpayers are not accustomed to using these forms, and taxpayers filing long-form 1040s are not eligible to use the various tax clinics offered by the IRS and others for lower-income taxpayers. The National Taxpayer Advocate reports that last tax year, less than one percent of electronic filers eligible for the exclusion claimed it.[56] If the definition of qualified mortgage debt is expanded as described above, the IRS can take steps through its tax forms to simplify the process for taxpayers claiming the mortgage debt exclusion.

3. Permit judicial modifications of mortgages on principal residences.

Judicial modification of loans is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century or investment banks like Lehman Bros., 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.

Permitting judges to modify mortgages on principal residences, which carries *zero cost to the U.S. taxpayer*, has been estimated to potentially help more than a million families stuck in bad loans keep their homes.[57] It would also help maintain property values for families who live near homes at risk of foreclosure. It would address the "moral hazard" objections to other modification proposals current under consideration, as the relief it provides would come at a substantial cost to the homeowner—including marring the homeowner's credit report for years to come and subjecting the homeowner's personal finances to strict court scrutiny. And it would complement the various programs that rely on voluntary loan modifications or servicer agreement to refinance for less than the full outstanding loan balance.

Proposals to lift this ban have set strict limits on how it must be done. Such proposals would require that interest rates be set at commercially reasonable, market rates; that the loan term not exceed 40 years; and that the principal balance not be reduced below the value of the property. And if the servicer agrees to a sustainable modification, the borrower will not qualify for bankruptcy relief because they will fail the eligibility means test. As Lewis Ranieri, founder of Hyperion Equity Funds and generally considered "the father of the securitized mortgage market,"[58] has recently noted, such relief is the only way to break through the problem posed by second mortgages.[59]

4. Create an independent Consumer Financial Protection Agency.

In light of our research, we believe there are several important additional steps Congress should take to prevent reckless lending that could once again fundamentally disrupt our economy. Most importantly is the creation of a single agency to safeguard consumer interests, such as the Consumer Financial Protection Agency embodied in legislation that passed the House of Representatives last month.[60]

The Consumer Financial Protection Agency would gather in one place the consumer protection authorities currently scattered across several different agencies, and would create a federal agency whose sole mission is consumer protection. The design of the Agency is appropriately balanced to enhance safety and soundness and allow appropriate freedom and flexibility for innovation while providing effective consumer protection. Highlights include the following:

- The Agency would have essential rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products and services that promote financial stability and asset-building on a market-wide basis.

- The Agency would have strong enforcement tools, along with concurrent authority for the States to enforce the rules against violators in their jurisdictions.

- The Agency would preserve the ability of states to act to prevent future abuses so that States would not be hamstrung in their efforts to react to local conditions as they arise.

- The Agency would have access to the real-world, real-time information that will best enable it to make evidence-based decisions efficiently.

In other areas of the economy, from automobiles and toys to food and pharmaceuticals, America’s consumer markets have been distinguished by standards of fairness, safety and transparency. Financial products should not be the exception – particularly since we have demonstrated that it is the subprime mortgage products themselves that raised the risk of foreclosure. A strong, independent consumer protection agency will keep markets free of abusive financial products and conflicts of interest. Dedicating a single agency to this mission will restore consumer confidence, stabilize the markets and put us back on the road to economic growth.

5. Prohibit predatory lending, particularly unsustainable loans, yield spread premiums and prepayment penalties.

It is also imperative to pass legislation that would require sensible and sound underwriting practices and prevent abusive loan practices that contributed to reckless and unaffordable home mortgages. For this reason, we urge the passage of H.R. 1728. While there are some ways in which this bill should be strengthened, it represents a critical step forward in requiring mortgage originators to consider the consumer’s ability to repay the loan and to refinance mortgages only when the homeowner receives a net tangible benefit from the transaction.

Most important, H.R. 1728 establishes bright line standards that will result in safer loans and in more certainty for originators of those loans. The bill's safe harbor construct would grant preferred treatment to loans made without risky features such as prepayment penalties, excessive points and fees, inadequate underwriting, and negative amortization. It would also ban yield spread premiums – which, as we explained earlier, were key drivers of the crisis – and it would permit states to continue to set higher standards if necessary to protect their own residents.

Similarly, we strongly support the Federal Reserve Board's proposal to ban yield spread premiums for all loan originators and prohibit steering consumers to unnecessarily expensive loans. The Board's proposed rule represents an important step forward in the recognition that disclosure alone is not enough to protect consumers and that certain practices themselves give rise to unfairness and unnecessary risk.

Many industry interests object to any rules governing lending, threatening that they won't make loans if the rules are too strong from their perspective. Yet it is the *absence* of substantive and effective regulation that has managed to lock down the flow of credit beyond anyone's wildest dreams. For years, mortgage bankers told Congress that their subprime and exotic mortgages were not dangerous and regulators not only turned a blind eye, but aggressively preempted state laws that sought to rein in some of the worst subprime lending.[61] Then, after the mortgages started to go bad, lenders advised that the damage would be easily contained.[62] As the global economy lies battered today with credit markets flagging, any new request to operate without basic rules of the road is more than indefensible; it's appalling.

Conclusion

Today's foreclosure crisis is the worst housing downturn since the Great Depression. The stakes are high. Not only have millions of families lost their homes, but the crisis is responsible for close to two trillion dollars in additional lost wealth, cuts in municipal services, shortages of affordable housing, and reduction of homeowner disposable income. As foreclosures mount, these related costs will only grow worse.

Even under a best-case scenario, the current crisis will continue and fester if interventions remain on the current narrow course. To make a real difference in preventing foreclosures and reducing associated losses, we need a multi-pronged strategy that strengthens the way current foreclosure prevention programs are implemented and also invests in new approaches. We also need better regulatory protection through a dedicated consumer protection agency.

As policymakers take actions to address the immediate crisis, it is our hope that they also will be mindful of policy failures that enabled the situation. Economic cycles and housing bubbles may always be with us, but the experience of recent years vividly shows the value of sensible lending rules and basic consumer protections, even during economic booms. It is critically important that policymakers translate the lessons of this crisis into sensible rules to prevent another disaster in the future.

We stand ready to assist the Committee on Oversight and Government Reform in your investigation of the foreclosure crisis, and we look forward to your findings on these matters of utmost importance to America.

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[1] *See, e.g.*, "Housing Starts and Vacant Units: No 'V'-Shaped Recovery," Calculated Risk (Nov. 15, 2009), *available at* http://www.calculatedriskblog.com/2009/11/housing-starts-and-vacant-units-no-v.html; Dean Baker, testimony before the Congressional Oversight Panel, "The Failures of TARP" (Nov. 19, 2009).

[2] MBA National Delinquency Survey, Feb. 19, 2010 [hereinafter "MBA National Delinquency Survey"]. The combined percentage of loans in foreclosure or at least one payment past due was over 15 percent on a non-seasonally adjusted basis, the highest ever recorded in the MBA delinquency survey.

[3] First American Core Logic Negative Equity Report Q42009, *available at* http://www.loanperformance.com/infocenter/library/Q4_2009_Negative_Equity_Final.pdf

[4] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected*, Credit Suisse (Dec. 4, 2008) (projecting 10 million foreclosures by 2012 depending on current unemployment rates); Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses: Projections and Policy Options*, Goldman Sachs Global Economics Paper (Jan. 13, 2009) (projecting 13 million foreclosures by 2014) at 16.

[5] Hope Now Phase I National Data (Nov. 2009), *available at* https://www.hopenow.com/industry-data/Summary%20Charts%20Nov%202009%2020100104%20v2.pdf.

[6] Standard and Poor's, "The Shadow Inventory of Troubled Mortgages Could Undo U.S. Housing Price Gains," Feb. 10, 2010. The shadow inventory problem is one reason that CRL does not agree with the claims by the Mortgage Bankers Association that the 17 basis point decline in the seasonally-adjusted delinquency rate marks the beginning of the end of the crisis. *See* Mortgage Bankers Association Press Release on the latest MBA National Delinquency Survey, Feb. 19, 2010, *available at* http://www.mbaa.org/NewsandMedia/PressCenter/71891.htm.

[7] Susan Saulny, *Banks Starting to Walk Away on Foreclosures*, New York Times (March 29, 2009), *available at* http://www.nytimes.com/2009/03/30/us/30walkaway.html.

[8] OCC and OTS Mortgage Metrics Report (Q3 2009), *available at* http://files.ots.treas.gov/482114.pdf

[9] "Fitch RMBS Loss Metrics," Fitch Ratings, Residential Mortgage Backed Securities Group (Jan. 2010).

[10] A. Frank, A. Rothschild, Y. Shen, "Monthly Review of Prime and Near-Prime Non-Agency," RMBS Observer, Global Markets Research, Deutsche Bank Securities, Inc. (Jan. 4, 2010).

[11] MBA National Delinquency Survey, *supra* note 2.

[12] For methodology, *see* Center for Responsible Lending, "Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average; Over Next Four Years, 91.5 Million Families to Lose $1.9 Trillion in Home Value; $20,300 on Average" (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

[13] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today*, (Jan. 8, 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/continued_decay_and_shaky_repairs.pdf.

[14] G. Thomas Kingsley, Robin Smith, & David Price, *The Impact of Foreclosures on Families and Communities,* The Urban Institute (May 2009), at 21, Fig. 3.

[15] D. Pelletiere, "Renters in Foreclosure: Defining the Problem, Identifying Solutions," National Low-Income Housing Coalition (Jan. 2010), *available at* http://dsl-router.nlihc.org/doc/renters-in-foreclosure.pdf.

[16] The "Helping Families Save Their Home Act of 2000," signed into law by President Obama in May 2009, provided that month-to-month tenants must receive 90 days' notice before having to move out and that tenants with leases may stay until the end of their lease (unless the owner plans to occupy the property, in which case tenants still must receive 90 days notice).

[17] Also, many tenants are not aware of their right to stay in their homes, and when they receive a notice from a bank lawyer naming their landlord and seeking eviction, they leave regardless of their legal rights. *See, e.g.,* Testimony of Deborah Cuevas Hill, The Legal Aid Society of the District of Columbia, before the Committee on Public Services and Consumer Affairs, Council of the District of Columbia (May 28, 2009), available at http://www.legalaiddc.org/issues/documents/TestimonyreTOPALegilsation.pdf.

[18] "Meeting Multifamily Finance Housing Needs During and After the Crisis: A Policy Brief," Joint Center for Housing Studies, Harvard University (Jan. 2009), *available at* http://www.jchs.harvard.edu/publications/finance/multifamily_housing_finance_needs.pdf.

[19] *Id.*

[20] It is popular, although incorrect, to blame the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the GSEs) for the foreclosure crisis. For a complete discussion of why CRA and the GSEs did not cause the crisis, *see* Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-testimony-10-16-08-hearing-stein-final.pdf.

[21] These were loans with debt-to-income ratios lower than 41%, 7/1 ARMs or more or fixed rate, a term of 30 years or less, no balloon payment, no interest-only or negative amortization, full documentation, and either an LTV under 80% or, if LTV above 80%, carried mortgage insurance.

[22] Vertical Capital Solutions, Historical Performance of Qualified vs. Non-Qualified Mortgage Loans, February 2010 (on file with CRL) [hereinafter "Historical Performance"].

[23] Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market*, Wall Street Journal at A1 (Dec. 3, 2007).

[24] Letter from Coalition for Fair & Affordable Lending to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (Jan. 25, 2007) at 3.

[25] Julie Bykowicz, *City can Proceed with Wells Fargo Lawsuit*, Baltimore Sun (July 3, 2009) *available at* http://www.baltimoresun.com/news/maryland/baltimore-city/bal-md.foreclosure03jul03,0,5953843.story..

[26] *See e.g.,* Yuliya Demyanyk, "Ten Myths About Subprime Mortgages," Economic Commentary, Federal Reserve Bank of Cleveland (May 2009) *available at* http://www.clevelandfed.org/research/commentary/2009/0509.pdf; Karen Weaver, "The Sub-Prime Mortgage Crisis: A Synopsis" Deutsch Bank (2008) *available at* http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_022_031_DB_US_SubPrm.pdf (concluding that subprime mortgages "could only perform in an environment of continued easy credit and rising home prices).

[27] Lei Ding, Roberto G. Quercia, Janneke Ratcliff, and Wei Li, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models" Center for Community Capital, University of North Carolina at Chapel Hill (Sept. 13, 2008) *available at* http://www.ccc.unc.edu/abstracts/091308_Risky.php.

[28] Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[29] *Id.*

[30] For example, a portion of this chart (the lines showing unemployment and mortgage delinquency) was circulated by the Mortgage Bankers Association as an advocacy tool to promote the notion that unemployment rather than bad practices was responsible for the current foreclosure crisis. However, once foreclosure data is added to the chart, it is quite clear that the same relationship did not exist during previous downturns. *See also* Historical Performance, *supra* note 23.

[31] Similarly, the "cure" rate – the rate at which homeowners who are behind on their mortgages catch up rather than default – has plummeted to an astonishing 6.6 percent. *See* Fitch Ratings, Delinquency Cure Rates Worsening for U.S. Prime RMBS (Aug. 24, 2009).

[32] Laurie Goodman, Roger Ashworth, Brian Landy, Ke Yin, Negative Equity Trumps Unemployment in Predicting Defaults, Amherst Mortgage Insight, Amherst Securities Group (Nov. 23, 2009) [hereinafter "Amherst Mortgage Insight"].

[33] It is worth noting that these external costs are not accounted for by the HAMP program's net present value analysis.

[34] We are not addressing HUD's Hope for Homeowners (H4H) program, which has had almost no participation so far. In addition, the refinancing portion of the Home Affordable initiative has also had much more limited reach than had been anticipated, with only 190,000 or so loans modified as of December 2009. http://fhfa.gov/webfiles/15389/Foreclosure_Prev_release_1_29_10.pdf.

[35] HAMP January loan modification report, released Feb. 17, 2010, *available at* http://www.financialstability.gov/docs/press/January%20Report%20FINAL%2002%2016%2010.pdf.

[36] *Id.*

[37] One Pennsylvania bankruptcy judge has recently provided troubling details of how "communications" between servicers and their outside law firms take place almost entirely through automated systems without any human interaction. *In re Taylor*, 407 B.R. 618 (E.D. Pa. 2009). That judge concluded, "The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system."

[38] "Treasury Considers Changes to HAMP," American Banker, Feb. 23, 2010.

[39] First American Core Logic, *supra* note 3.

[40] Homeowners with equity in their homes are generally able to refinance into lower rate loans and are much less likely to get into a situation where they require assistance.

[41] Amherst Mortgage Insight, *supra* note 33.

[42] Although many decry the phenomenon of "walkaways," when people voluntarily default on their mortgages, there are actually far fewer such walkaways than economic theory might predict. *See, e.g.*,

Roger Lowenstein, *Walk Away from your Mortgage!*, New York Times (Jan. 10, 2010) (noting that it would be economically rational for more people to walk away from their mortgages). However, it is clear that at some level, the disincentive of being underwater will have an impact on the homeowner's success in continuing with the mortgage.

[43] Andrew Haughwout, Ebiere Okah, and Joseph Tracy, *Second Chances: Subprime Mortgage Modification and Re-Default*, Federal Reserve Bank of New York Staff Report (Dec. 2009).

[44] Servicers with large POARM books are moving many of these homeowners into 10-year interest-only loans, which is helpful in the short term but is ultimately only postponing the day of reckoning if the housing market does not recover rapidly, which is not expected.

[45] *See, e.g.*, Testimony of Laurie Goodman before the House Financial Services Committee (Dec. 8, 2009), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/goodman.pdf; Shawn Tully, *Lewie Ranieri Wants to Fix the Mortgage Mess*, Fortune Magazine (Dec. 9, 2009); "Analysis of Mortgage Servicing Performance, Data Report No. 4, Jan. 2010, State Foreclosure Prevention Working Group, at 3.

[46] For a thorough discussion of the many conflicting incentives prevailing in the servicing industry, *see* Diane E. Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior*, National Consumer Law Center (Oct. 2009), *available at* http://www.nclc.org/issues/mortgage_servicing/content/Servicer-Report1009.pdf

[47] *See* Testimony of Julia Gordon before the House Committee on Financial Services (Dec. 8, 2009), available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/Gordon-Loan-Modification-Testimony-12-8-09-final.pdf.

[48] *See* Howell Jackson, *Build a Better Bailout*, The Christian Science Monitor (Sept. 25, 2008), available at http://www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html; *see also* Andrew Jakabovics, *Sustainable Mortgage Modifications: Setting Clear Benchmarks to Measure Progress and Identifying Possible Next Steps to Contain the Foreclosure Crisis*, Center for American Progress (March 2009), available at http://www.americanprogress.org/issues/2009/03/pdf/mortgage_modifications.pdf.

[49] See discussion of spillover costs in Section IB.

[50] Even beyond the many more homeowners likely to default due to financial hardship, it is also likely that many more will default "strategically" than are doing so right now. First American Core Logic notes that above 125% LTV, owner-occupants begin to default at rates equal to investors. See *supra* note 3.

[51] Chris Foote, Jeff Fuhrer, Eileen Mauskopf, and Paul Willen, *A Proposal to Help Distressed Homeowners: A Government Payment-Sharing Plan*, Federal Reserve Bank of Boston Public Policy Briefs (No. 09-1) (July 9, 2009).

[52] Homeownership Preservation Summit Statement of Principles (May 2, 2007), http://dodd.senate.gov/index.php?q=node/3870/print (the Summit resulted in a statement of Homeownership Preservation Principles announced by Chairman Dodd, and endorsed by the Mortgage Bankers Association, CitiGroup, Chase, Litton, HSBC, Countrywide, Wells, AFSA, Option One, Freddie Mac, and Fannie Mae).

[53] Diane E. Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior*, *supra* note 47.

[54] *See, e.g.*, Chris Arnold, *Are There More Foreclosures Than Necessary?* National Public Radio Planet Money (May 15, 2009). http://www.npr.org/templates/story/story.php?storyId=104177396

[55] National Taxpayer Advocate, *2008 Annual Report to Congress*, at 341, 391-96.

[56] *Id.* at 394.

[57] Mark Zandi, "Homeownership Vesting Plan," Moody's Economy.com (Dec. 2008), *available at* http://www.dismal.com/mark-zandi/documents/Homeownership_Vesting_Plan.pdf.

[58] *Lewis Ranieri to deliver Dunlop Lecture on Oct. 1*, Harvard University Gazette, Sept. 25, 2008, *available at* http://news.harvard.edu/gazette/story/2008/09/lewis-ranieri-to-deliver-dunlop-lecture-on-oct-1/.

[59] 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 Feb. 24, 2010).

[60] Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173), which passed the House of Representatives on December 11, 2009.

[61] *See* Testimony of Kathleen Keest before the House of Representatives Committee on Financial Services, June 24, 2009, *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/regulatory_restructuring_testimony_keest_06242009.pdf.

[62] For example, in September 2006, Robert Broeksmit of the Mortgage Bankers Association told Congress, "Our simple message is that the mortgage market works and the data demonstrate that fact," and "I strongly believe that the market's success in making these 'nontraditional' products available is a positive development, not cause for alarm." Statement of Robert D. Broeksmit, Chairman, Residential Board of Governors, Mortgage Bankers Association, Before a Joint Hearing of the Subcommittee on Housing and Transportation and the Subcommittee on Economic Policy, U.S. Senate Committee on Banking, Housing and Urban Affairs, Calculated Risk: Assessing Non-Traditional Mortgage Products, *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=54647cfe-de8f-4eb8-8952-452fb8754862. In May 2007, John Robbins of the Mortgage Bankers Association said, "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy. And we're not the only ones who think so." John M. Robbins, CMB, Chairman of the Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, D.C. , *available at* http://www.mortgagebankers.org/files/News/InternalResource/54451_NewsRelease.doc.