HR 3609 - Compromise Bill Permitting Court-Supervised Loan Modifications Would Save 600,000 Homes

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The subprime crisis is severe and will get worse.

Dangerous lending practices and loose underwriting in the subprime mortgage market have put 2.2 million families in danger of losing their homes to foreclosure and is predicted to cause $350 billion of losses to financial institutions.[1] Millions of thousands of families are trapped in "exploding" adjustable-rate mortgages (ARMs) that are due to increase to unaffordable interest rates in 2008, at the same time that their houses are worth less than their mortgage balance.

Very few of these homeowners will be able to sell or refinance. Loan servicers who could modify loans to make them more affordable aren't doing so: A recent report by Moody's found that loan servicers had only modified 3.5 percent of mortgages that increased to higher rates, compared with industry estimates that <u>up to half</u> of subprime borrowers facing reset will lose their homes to foreclosure.[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.

Today distressed homeowners are denied equal access to court-supervised protections. Judicial modification of loans under a chapter 13 payment plan is available for owners of commercial real estate and yachts, 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 courts are <u>not</u> permitted to modify.

HR 3609 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. HR 3609 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]

HR 3609 was reported out of the House Judiciary Committee on December 12, after being amended pursuant to a compromise between Committee Chairman John Conyers (D-MI), Subcommittee Chairwoman Linda Sanchez (D-CA) and Rep. Brad Miller (D-NC), and Representative Steve Chabot (R-OH). The compromise bill tightens the original HR 3609 by limiting relief as follows:

- <u>Relief available only when family lacks sufficient income to pay their mortgage and foreclosure is imminent.</u> A strict means test limits relief to those homeowners whose income is insufficient, after deducting modest living expenses allowed by the IRS, to cover their mortgage obligations. In addition, relief is limited to borrowers who have received notice from their servicer that foreclosure is imminent. Finally, there is a good-faith requirement that allows courts to exclude anyone who wrongly makes it through those 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.

- 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.

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

- 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.

- Sunrise/Sunset. The bill applies only to loans originated on or after January 1, 2000, and, for these loans, is subject to a seven-year sunset.

The Benefits of Court-Supervised Loan Modifications

- 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]
- Guarantees lenders at least the value they would obtain through foreclosure, since a foreclosure sale can only recover the market value of the home. In addition, saves lenders the high cost and significant delays of foreclosures.

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 Center for Responsible Lending, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," December 2006, http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf.); Merrill Lynch, Weekly guidebook for the global investor, Dec. 14, 2007.

2 Aashish Marfatia, Moody's Investors Service, Structured Finance Special Report, US Subprime Market Update: November 2007, (Dec. 17, 2007) at 2; Christopher Cagan, cited in Ivry, Bob, "Subprime Borrowers to Lose Homes at Record Pace as Rates Rise" (Sept. 19, 2007), Bloomberg, available at: http://www.bloomberg.com/apps/news?pid=email_en&refer=finance&sid=akOEPec30TR4.

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