<u>Testimony of Eric Stein</u>
Center for Responsible Lending

Before the U.S. House Judiciary Committee
Subcommittee on Commercial and Administrative Law

"Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress"

<u>September 25, 2007</u>

Chairman Sánchez, Ranking Member Cannon, and members of the Subcommittee, thank you for holding this hearing on how we can protect homeownership and provide relief to consumers in financial distress. In the past few months, we've seen the adverse effects of abusive subprime loans spread across the nation, from California to the Midwest to Florida, and the ripple effects are now evident worldwide. We commend you for focusing on the problem and seeking positive solutions.

<u>Executive summary</u>

I. Without policy intervention, subprime foreclosures will cause a widespread national crisis.

We estimate that 2.2 million families will lose or have lost their homes to foreclosure due to reckless subprime lending, including one out of every five subprime mortgages made in 2005 and 2006. The foreclosures today are the worst they've been in at least 25 years, and the problem is growing. The cost of the subprime problem extends far beyond the families who lose their homes. Millions of other families—who faithfully paid their mortgages—will be hurt by declines in property values spurred by nearby foreclosures and a weaker housing market**.** *In fact, the losses associated with the 2.2 million completed foreclosures, if not averted, will total $265 billion in wealth lost by American families* ***not*** *facing foreclosure*. In addition, our national economy has been severely affected already by the subprime meltdown. Over 100 mortgage lenders already have gone out of business. The stock market is increasingly volatile and the housing market is facing its first national decline since the Great Depression.

II. The only policy change that can forestall this crisis is tweaking chapter 13 to provided equal access to homeowners.

A. The only current option is loan modifications, and they are rarely provided.

The risk is highest for a family facing an exploding ARM reset -- whose rates rise sharply two years after origination, resulting in massive and unaffordable payment increases. For these four to five million families, none of their options are good ones. First, they can try to continue to make the payments, which is not realistic given the 40% payment increase. Second, they can try to refinance into another loan, but property declines, inflated appraisals, prepayment penalties, mortgage delinquencies, and the drying up of the subprime market make this frequently impossible. Third, they often cannot sell for enough to pay off the mortgage.

Under current law, only two options remain: loan modification or foreclosure. The most favorable is for the family to negotiate with the lender to modify the loan to make it affordable. Unfortunately, *lenders are not modifying loans in significant numbers*. Housing counselors and attorneys in the field concur with recent Moody's findings to this effect: "most servicers had only modified approximately 1% of their serviced loans that experienced a reset in the months of January, April and July 2007."

Obtaining a loan modification can be difficult because it is often impossible to locate the holders of the mortgage to negotiate with; servicers fear being sued by investors if they modify, even when in the interest of investors as a whole; servicers are overwhelmed; and the most intractable, subprime borrowers with piggyback second mortgages create a prisoner's dilemma that neither holder has an interest in agreeing to a modification.

This leaves foreclosure. No wonder that *researchers at First American CoreLogic report that up to* ***half*** *of the 450,000 families who are holding subprime mortgages whose payments will reset shortly will lose their home to foreclosure*.

B. The solution: tweak the bankruptcy code to permit mortgage loan modifications.

Congress can ameliorate the worst of the crisis yet to come, but only through allowing mortgages to be modified through chapter 13. *Currently, federal law makes the mortgage on the primary residence the only debt that bankruptcy courts* ***cannot*** *modify – even though courts can modify mortgages on investment properties and vacation homes*. This makes no sense. Because the home mortgage exception applies only to primary residences, borrowers wealthy enough to own two homes or speculators whose investments have gone bad can obtain relief from the mortgage on their vacation or investment home, thereby retaining at least one shelter for their family. Judges have the ability to modify loans securing their home for family farmers, whose bankruptcies are governed by chapter 12, and owners of commercial real estate and all businesses, who are subject to chapter 11. Thus, the current bankruptcy law deprives mostly low-wealth and middle class families of protections available to all other debtors and grants lenders on home mortgages a special protection not available to any other type of lender.

III. The proposed amendment provides significant benefits.

The most immediate beneficiaries would be families who otherwise would lose their house, and perhaps their life savings, to foreclosure. We estimate that *600,000 families facing subprime exploding ARMs would be able to save their homes. By opening up* *bankruptcy protection to homeowners, the most important result will be for those who will no longer need to file chapter 13 because they will receive a voluntary modification instead*. The change will remove the fear that servicers have of getting sued by investors, as well as establish standards that servicers will adopt for sustainable loan modifications.

Our proposal guarantees lenders the value of the property that they took as collateral; the secured portion of the loan would not be reduced below this amount. In fact, this is a *better deal than the lender would get at foreclosure*, which causes significant delays of one to two years, the lender receives liquidation value, and incurs substantial expenses. Loan modification in bankruptcy does not increase the loss that will be taken by a lender/investor in foreclosure; it just allows the process to reach a resolution without a homeless family and boarded-up home as the unnecessary by-products. The loan modification would also ensure a continued stream of interest income to the lender, and would prop up property values by avoiding massive foreclosures, which would reduce the value of their other loans.

This proposal saves American families not facing foreclosure $72.5 billion in wealth by avoiding 600,000 foreclosures by their neighbors, and the associated property value declines. Encouraging vacant, boarded-up homes by a policy of favoring foreclosure over loan modification in chapter 13 bankruptcy has the terrible likelihood of trapping distressed borrowers in homes where the mortgage is higher than the property value. This change imposes no cost on taxpayers, and does not create a moral hazard by bailing out investors with public money. By preventing so many foreclosures, it will improve the finances of local municipalities, who save $30,000 for each foreclosure averted.

It will not hurt the economy or housing market. The bankruptcy remedy is a very targeted response. Bankruptcy involving one's home is a last resort for almost all families, given the stigma and five years of intrusive financing management under supervision of a bankruptcy judge. *While this is a significant impact on the current foreclosure epidemic, this result is still just 0.6% of all households and 1.4% of all homeowner households with outstanding mortgages*.

The spillover effects of concentrated foreclosures pose a much more real risk to freezing up local housing markets in states like California, Florida, Ohio, Nevada, Arizona, and the 41 other states where foreclosures are up significantly over the past year *than this change to the bankruptcy code.*

Lending experience during the fifteen years in which bankruptcy courts were modifying mortgage loans on primary residences belies some lenders' claim that allowing such modifications would negatively impact the cost or availability of credit. The claim is similarly belied by the past thirty years, continuing to the present, in courts have been modifying mortgage loans on family farms, investment properties, vacation homes and commercial real estate with no ill effects on those submarkets.

Self-Help and Center for Responsible Lending

My day job is as a lender; I serve as Chief Operating Officer of Self-Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. I also serve as Senior Vice President of Self-Help's affiliate, the Center for Responsible Lending (CRL) (www.responsiblelending.org), which is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

For the past 26 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 home loans. In other words, we work to provide fair and sensible loans to the people most frequently targeted for predatory and abusive subprime mortgages. Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country. Our loan losses have been less than one percent per year.

In addition to making direct loans, Self-Help encourages sustainable loans to borrowers with blemished credit through a secondary market operation. We buy these loans from banks, hold on to the credit risk, and resell them to Fannie Mae. We have used the secondary market to provide $4.5 billion of financing to 50,000 families across the country, loans that have performed well and significantly increased these families' wealth.

Through this lending experience, I understand the importance of promoting sustainable homeownership and maintaining access to affordable home loans, and I have an appreciation of how responsible use of the secondary market can contribute to such a result.

As a lender, I can promise you that proposing a change to the nation's bankruptcy laws was not the first thought that leapt to mind; it was a process of elimination where we thoroughly considered every other option we could think of, pursued them as far as they would go, and found each wanting to meet the goal of having a large scale impact. We have been involved in most every major effort to figure out what to do to assist current borrowers – summits convened by FDIC and Senator Dodd; efforts led by a group of attorneys general; efforts led by officials in numerous states; and extensive discussions with major lenders, secondary market players, and members of Congress. Changing the bankruptcy code is simply the only thing that any party can do that will keep hundreds of thousands of families in their homes. There is no other option.

The bottom line

Because of the dangerous subprime loan products offered over the last five years, particularly the exploding ARMs, plus the weak underwriting fostered by unquestioning investor demand, there will be substantial losses that somebody will bear. The question facing Congress is who shall bear these losses. There are only three possibilities:

- Taxpayers. A savings and loan type bailout of many hundreds of billions of dollars is possible to pay off unaffordable mortgages. Beyond the cost to a country already in substantial deficit, this strategy would have the result of saving investors from loss, creating a moral hazard that would likely cause a repeat.

- Investors. So long as there isn't a taxpayer bailout, then investors, who signed up to take the rewards and bear the risk, will necessarily reap what they have sown. The losses will come and holders of subprime securities will feel the effects.

- Homeowners, neighbors and the economy. Congress will decide whether the investors will bear the risk alone, or whether they will also cause 600,000 families to needlessly lose their homes, neighbors who were paying their mortgages to needlessly lose $72.5 billion in wealth, and the wider economy to needlessly bear the ripple effects of these economic losses and vacant homes. The bankruptcy tweak suggested here today will keep losses from filtering down to the parties least able to sustain them, and who never signed up to take them.

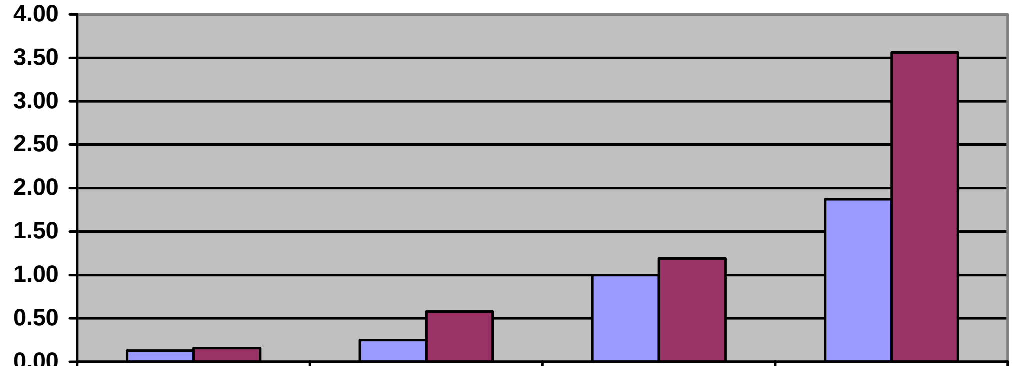
I. Without policy intervention, subprime foreclosures will cause a widespread national crisis.

Today, because of reckless lending practices in the subprime market and voracious investor demand for the resulting loans,[1] we estimate that 2.2 million families have lost or will lose their homes to foreclosure. These foreclosures already are occurring in record numbers, and the worst is still ahead. This is a true national crisis; in fact, this epidemic of foreclosures has been called the "Fifty-State Katrina." The difference is that this disaster, unlike a hurricane, was entirely man-made and avoidable.

Subprime mortgages are no longer a niche market; they have become a significant share of all new mortgages made in America, making up well over 20 percent of all home loans originated in 2006 and currently representing $1.2 trillion of mortgages currently outstanding.[2] Six million of these loans are outstanding. Eighty percent of 2006 subprime loans were so-called 2/28 mortgages,[3] otherwise known as "exploding ARMs", whose interest rates are set to increase from 8% - 9% to 12% - 13% immediately after the second year, even with interest rates in the economy remaining constant. Even with the recent modest cut in interest rates, subprime borrowers will face 40 percent or greater increases in their monthly mortgage payments once their initial "teaser" rates expire and their fixed interest rates reset into higher-rate variable rates.

We estimate that one out of every five subprime mortgages made in 2005 and 2006 will end in families losing their homes to foreclosure.[4] The foreclosures occurring today are the worst they've been in at least 25 years, and the problem is growing. The 2nd Quarter National Delinquency Survey, recently released by the Mortgage Bankers Association (MBA), shows that new foreclosures on subprime adjustable-rate loans in the second quarter 2007 are **90%** higher than the same time last year, compared with a 23% increase on prime fixed-rate loans.[5]

% Foreclosures Started During Quarter



	Prime Fixed-Rate	Prime ARM	Subprime Fixed Rate	Subprime ARM
2Q 2006	0.13	0.25	1.00	1.87
2Q 2007	0.16	0.58	1.19	3.56

Source: MBA National Delinquency Survey

The MBA data show that mortgage loans entering foreclosure have increased in 47 states since this time last year; on average, 50% higher. Only four states, together totaling less than two percent of the American population, did not experience increases in new foreclosures.

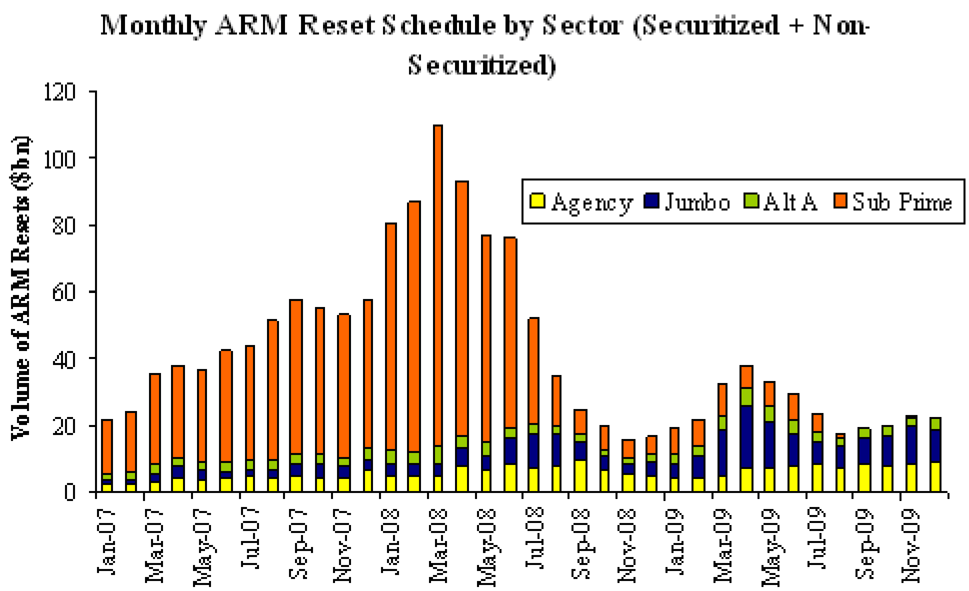
- These losses represent a personal catastrophe for each of families involved. For most, their only "wealth" is their home equity, which will now have been stripped by these loans even if the family avoids foreclosure. Many of these households will be displaced and pushed backwards financially, some into homelessness. Some will take years to recover, and many never will. It takes an average of ten years for a family to return to homeownership after a foreclosure.[6]

The cost of the subprime problem extends far beyond the families who have lost or will lose their homes, however.

- Millions of other families—those who have faithfully paid their mortgages on time—will be hurt by declines in property values spurred by nearby foreclosures and a weaker housing market. In fact, the losses associated with the 2.2 million completed foreclosures, if not averted, will total $265 billion in wealth lost by American families *not* facing foreclosure.[7]

- Our national economy has been severely affected already by the subprime meltdown. Over 100 mortgage lenders already have gone out of business and tens of thousands of workers have lost their jobs. It's harder for mortgage lenders and firms in other business lines to get credit from once-burned, twice shy investors. The stock market is increasingly volatile and the housing market is facing its first national decline since the Great Depression. All these factors spell slower (or even negative) economic growth in the U.S and—with German banks worried about subprime loans made in Chicago—bleak prospects for help from players in other global financial markets.[8]

It is important to recognize that while the rate of subprime foreclosures is alarming today, the worst is still ahead. As the chart below shows, a large majority of these rate resets will occur later this year and in early 2008.[9]



II. The only policy change that can forestall this crisis is tweaking chapter 13 to provided equal access to homeowners.

A. The sole current option to avoid foreclosure for many is loan modifications, and they are rarely provided.

It is very difficult for homeowners in unsustainable loans to avoid foreclosure. Many subprime borrowers in fixed-rate mortgages are in trouble due to risky elements of their loans, including the lack of appropriate underwriting, appraisal fraud, prepayment penalties, lack of property tax and hazard insurance escrows, and other equity-stripping measures. Alt A borrowers, one step up from subprime, are increasingly facing payment difficulties, as are those in so-called non-traditional loans such as payment option ARMs and interest-only loans provided by lenders not schooled in this type of lending.[10] Finally, in the face of property declines, even prime borrowers are feeling stress and delinquency.

The risk is highest at the moment though for a family facing an exploding ARM reset -- that is, 2/28 hybrid adjustable rate mortgages, whose rates rise sharply two years after origination, resulting in massive and frequently unaffordable payment increases.[11] For these four to five million families, none of their options are good ones.

- Stay in the loan. First, they can try to continue to make the payments. While many borrowers drain retirement funds or forgo essentials such as medicine or food in an effort to make their mortgage payments, the fact is that few will be able to sustain their payments at this level. In these loans, the debt-to-income ratios were often unsustainably high even at the introductory "teaser" rates – often 50% to 55% of gross monthly income – and now, for many borrowers, the increased payment will approach or exceed their total net monthly income after the interest rate adjustment. This option is simply not realistic for the vast majority of borrowers.

- Refinance. Second, they can try to refinance into another loan. Some borrowers who still have some equity and who have a regular income may be able to refinance into another loan. But borrowers caught unaware by a reset who are now delinquent on their mortgages or borrowers who lack sufficient equity either due to housing depreciation, appraisal fraud, and/or equity-stripping may not be able to refinance. Moreover, many of the lenders that extended these loans are themselves filing for bankruptcy,[12] and the subprime market has largely dried up.

- Sell. Third, they can try to sell their house. However, the same obstacles that keep them from refinancing face them again. Because these loans were underwritten with such high loan-to-value ratios, the slow-down or reversal of home price appreciation along with the appraisal fraud and equity-stripping common to these loans, means that a sale would not net sufficient proceeds to cover the outstanding debt. Further, the equity they recoup must cover applicable prepayment penalties (which are included in over two-thirds of subprime loans). In some real estate markets, especially in neighborhoods hard hit by multiple foreclosures, it may not be possible to sell at all. Selling the house and paying off an unaffordable mortgage is increasingly difficult to do.

Under current law, only two options remain: loan modification or foreclosure.

- Servicer modifications. The most favorable option is for the family to negotiate with the lender to modify the loan to make it affordable. Such modifications can include interest rate and principal reductions, forgiveness of loan payments, or loan period extensions."[13]

  The centrality of the modification option was recognized by President Bush on August 31, when he said, "I've made this a top priority to help our homeowners navigate these financial challenges, so that many families as possible can stay in their homes. …I strongly urge lenders to work with homeowners to adjust their mortgages. I believe lenders have a responsibility to help these good people to renegotiate so they can stay in their home."[14]

  Unfortunately, despite the President's call to action and much public discussion of how lenders stand ready to help borrowers avoid foreclosure, in practice, lenders are not modifying loans in significant numbers. While it is very difficult to get information about modifications from lenders, the experience of housing counselors and attorneys in the field is that meaningful modifications are rare.[15] Just last week, Moody's surveyed the modification practices of subprime servicers constituting 80% of the total market regarding borrowers whose mortgages reset in 2007 or 2008. Moody's concluded that subprime losses will continue to increase, and it will have to continue to downgrade subprime securities, because "most servicers had only modified approximately 1% of their serviced loans that experienced a reset in the months of January, April and July 2007."[16]

Obtaining a loan modification can be difficult for four reasons.

- Who owns the loan? It is important to realize that most borrowers will be negotiating with a servicer of their loan rather than with their original lender. People facing foreclosure in previous mortgage crises had the advantage of being able to go to their local bank or savings and loan to negotiate directly with the entity that made the loan, serviced it, and held the economic interest; since the lender faced significant losses from foreclosure, a win-win modification could often be worked out. The world has changed, however. Many borrowers and even their servicers simply cannot locate the holders of the mortgage to negotiate with; the loans have been sliced and diced so many times that the owners cannot be found.

- Fear of investor lawsuits. The servicer has obligations to the investors who have purchased the mortgage-backed securities through pooling and servicing contracts, and the interests of these investors conflict. Servicers are hesitant to modify the loans because they are concerned that it will impact different tranches of the security differently, and thereby raise the risk of investor lawsuits when one or more tranche inevitably loses income. This phenomenon is known as "tranche warfare". For example, a modification that defers loss will favor the residual holder if the excess yield account is released, but will hurt senior bondholders. The legally safest course for the servicer is clearly foreclosure.

- Servicers are overwhelmed. The magnitude of the crisis has simply been too much for many servicing operations to effectively respond. Hundreds of thousands of borrowers are asking for relief from organizations that have traditionally had a collections mentality, been increasingly automated, and whose workers are simply not equipped to handle case-by-case negotiations. Further, many of these servicers are affiliated with lenders who are going bankrupt or are facing severe financial stress, and therefore are cutting back just as the demands are increasing significantly.

- Piggyback seconds. The most intractable problem is the fact that a third to a half of 2006 subprime borrowers took out piggyback second mortgages on their home at the same time as they took out their first mortgage.[17] In these cases, the holder of the first mortgage has no incentive to provide modifications that would free up

> borrower resources to make payments on the second mortgage. At the same time, the holder of the second mortgage has no incentive to support an effective modification, which would likely cause it to face a 100% loss. The holder of the second is better off waiting to see if a borrower can make a few payments before foreclosure. Beyond the inherent economic conflict, dealing with two servicers is a negotiating challenge that most borrowers cannot surmount.

Since bankruptcy isn't an option to save their home under current law, foreclosure is the only option for these families. *No wonder that researchers at First American CoreLogic reported last week that up to* ***half*** *of the 450,000 families who are holding subprime mortgages whose payments will increase in the next three months will lose their home to foreclosure*.[18]

B. The solution: tweak the bankruptcy code to permit mortgage loan modifications.

With as many as 1.7 million foreclosures predicted to occur in the next two to three years,[19] it is imperative that Congress take action to assist homeowners struggling today, not just protect future subprime borrowers. Congress can ameliorate the worst of the crisis yet to come, but only through implementing a single policy change, the one the Judiciary Committee is considering now. Currently, federal law makes the mortgage on the primary residence the only debt that bankruptcy courts *cannot* modify – even though courts can modify mortgages on investment properties and vacation homes. This makes no sense. This simple tool – providing homeowners equal access to chapter 13 bankruptcy relief – will reduce devastation and benefit the entire economy, without expenditure of taxpayer dollars

The 2005 bankruptcy law had the intended effect of shifting debtors from chapter 7, where their debts are liquidated, to chapter 13, where they paid their debts back to the best of their ability through a three to five year payment plan. Chapter 13 has a preexisting problem, however, that renders it useless for addressing the current subprime foreclosure crisis. The issue is that a 30-year-old clause in chapter 13 of the Bankruptcy Code makes the home mortgage virtually the only debt that the court cannot modify and therefore the home the only asset it cannot protect.[20] This special protection applies only to the mortgage on the primary residence; bankruptcy courts are free to modify loans for investors or speculators having trouble making payments on second homes, vacation homes, boats, family farms, and commercial real estate. Since a home is typically the largest and most important asset a family has, and the home mortgage loan is the family's largest single debt, the exclusion of the principal residence from modification prevents bankruptcy protection from reaching where it is needed most.

We propose simply eliminating this anomaly.

Our proposal does not revisit the 2005 amendments to the Bankruptcy Code, but rather addresses the provision from the 1978 Code. Our proposal follows the roadmap laid out by the successful Family Farmer Bankruptcy Act of 1986, which has enabled courts to modify loans on a borrower's principal residence that is located on their farms.

We suggest that Congress amend the provision found at 11 USC §1322(b)(2), which empowers the court to "modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of unsecured claims…" (emphasis supplied). All that is required to make this change is to strike the italicized language, and make several other modest conforming changes, most importantly to enable the mortgage to repaid over a period longer than the three to five year plan – namely, 30 years less the number of years the borrower has been in their home. (See Appendix B for full list of recommendations.)

The result of this change would be to permit a bankruptcy judge in chapter 13 to do two things. First, if the borrower were "upside down", with the mortgage value higher than the value of the property, the judge would bifurcate the mortgage into two classes. The first class would be secured to the value of the property. The second would be the remainder of the mortgage, which would be placed on par, and paid pro rata with, other unsecured debt. Second, the judge could modify the interest rate, for example, by making the introductory rate in an exploding ARM permanent, and reamortizing the loan over the remaining life. As a result of this change, a loan a family would have no prospect of paying could now become affordable.

The language we seek to change was enacted in 1978, a time when virtually all home mortgages were fixed-interest rate instruments with low loan-to-value ratios. The loans were rarely the source of a family's financial distress. As originally introduced, the House legislation permitted a plan to modify any secured indebtedness, including that represented by a home mortgage.[21] During Senate hearings on the proposed legislation, advocates for secured lenders suggested that home-mortgage lenders were "performing a valuable social service through their loans," and "needed special protection against modification." At their urging, the original proposal was subsequently amended to insert the exception for mortgages on primary residences.[22] This claim likely succeeded through effective lobbying since, as described below in section III, the merits of the argument are groundless. Whatever the merits of this claim in 1978, however, when home mortgage loans were responsibly underwritten thirty-year fixed rate loans, it plainly does not apply to the practices of subprime mortgage lenders during the last decade.

Even at that time, many bankruptcy courts avoided the provision's harsh result by finding exceptions to the blanket prohibition on modifying home mortgage loans, e.g., by finding that the exemption applies only to the extent that the outstanding loan balance did not exceed of the value of the home, or by finding that it only applies to purchase money lending and not refinances.[23]

But in 1993, in *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993), the Supreme Court held that bankruptcy courts must apply section 1322(b) according to its express, literal terms. The practical effect of this decision is that borrowers stuck in unaffordable home loans now must cure their defaults and, in addition, make monthly payments on the mortgage loans according to the often inflated and abusive terms or lose their homes.

This result is not only unwise; it is also unfair. Because the home mortgage exception applies only to primary residences, borrowers wealthy enough to own two homes or speculators whose investments have gone bad can obtain relief from the mortgage on their vacation or investment home, thereby retaining at least one shelter for their family. Judges have the ability to modify loans securing real estate for family farmers, whose bankruptcies are governed by chapter 12, and owners of commercial real estate and all businesses, who are subject to chapter 11.[24] Thus, the current bankruptcy law deprives mostly low-wealth and middle class families of protections available to all other debtors and grants lenders on home mortgages a special protection not available to any other type of lender.

III. The proposed amendment provides significant benefits.

A. Debtors.

The most immediate beneficiaries would be families who otherwise would lose their house, and perhaps their life savings, to foreclosure. As described in Appendix A, *we estimate that 600,000 families facing subprime exploding ARMs would be able to save their homes*. These savings would result from two different factors. First, those families that file chapter 13, have their mortgages modified, and successfully complete their plans, would benefit by keeping their homes. Chapter 13 bankruptcies for families in such loans would have a much greater chance of success than current plans, because of the ability to modify an abusive loan.

Second, perhaps counter-intuitively, by opening up bankruptcy protection to homeowners, the most important result will be for those who will no longer need to file. The change will remove the fear that servicers have of getting sued by investors, as well establish standards that servicers will adopt for sustainable loan modifications. In addition, the fact that a modification could be pursued in bankruptcy proceedings might provide an incentive for lenders and servicers to offer their own modification plans.

The vast majority of families would much prefer to avoid filing for bankruptcy, and would find a voluntary modification incomparably preferable to the necessity of entering bankruptcy. In fact, the change could actually reduce the number of bankruptcy cases filed overall, as families who receive voluntary modifications would not need to file to stay a foreclosure, as is common today as a holding pattern since bankruptcy can't modify the mortgage.

The proposed amendment will help typical borrowers such as one client whom a bankruptcy attorney recently told us about. This 77-year old, African-American widower on a fixed income from Social Security was financed into an unaffordable subprime hybrid ARM that has already seen two upward rate adjustments. He has been in a chapter 13 plan since October of 2005, but his plan payments keep rising due to the mortgage adjustments. Since he has no place to move to, he is trying to stick with the chapter 13 for now, but if his monthly mortgage payments continue to increase, he will eventually end up losing his home.

Under our proposed change in the bankruptcy law, the debtor's mortgage could be reamortized for 30 years less the number of years he's been in the loan at a lower fixed rate that would be affordable. Not only would the payments be lower, but the debtor would not have to make additional payments toward arrears. In short, he would be able to be restored to approximately the same position he was in before the abusive loan, albeit having lost some equity in his house.

B. Creditors.

Our proposal guarantees lenders at least the value of the property that they took as collateral; the secured portion of the loan would not be reduced below this amount. In fact, this is a better deal than the lender would get at foreclosure, which would be the result absent the proposed change. When foreclosing, a lender faces significant delays of commonly one to two years before getting some of its money back through selling the house (see Appendix C). In addition, at foreclosure auction the lender receives what is called liquidation value, because it is a distressed sale. Finally, the lender incurs substantial expenses in keeping up the property, fixing it up if necessary, and paying for legal costs. As a result, lenders generally lose 30 to 40 cents on the dollar, and more in declining property value regions, when foreclosing. In other words, loan modification in bankruptcy does not increase the loss that will be taken by a lender/investor in foreclosure; it just allows the process to reach a resolution without a homeless family and boarded-up home as the unnecessary by-products.

This discrepancy between the appraised value used in our proposal and liquidation value actually received by the lender is why many observers have made the strong argument that the mortgage shouldn't be crammed down to the appraised value of the house, but rather to its liquidation value less expected transaction costs.

The lender would benefit by our proposal because a loan modification would ensure a continued stream of interest income. The modifications that judges would order, or that would be voluntarily agreed upon outside of bankruptcy, are no different than what lenders agreed to in the summit convened by Senator Dodd, what bank regulators have urged lenders to do, and what industry best practice is.[25] The presence of the bankruptcy option would enable the lender to act in the most economically beneficial way, without fear of investor lawsuit.

In addition, the lender would benefit from the propping up of property values by avoiding massive foreclosures, which would serve to decrease the value of property underlying existing loans, increase both the incidence and severity of default on those loans, and therefore decrease the loans' value.

C. Neighbors.

Foreclosures depress values of nearby houses. The Woodstock Institute determined that each foreclosure on a city block reduces property values on each house by 1.14%. Thus, our proposal saves American families <u>not</u> facing foreclosure $72.5 billion in wealth by avoiding 600,000 foreclosures by their neighbors.[26] Encouraging vacant, boarded-up homes by a policy of favoring foreclosure over loan modification in chapter 13 bankruptcy has the terrible likelihood of trapping distressed borrowers in homes where the mortgage is higher than the property value, due to these property declines.

A recent *USA Today* cover story described the plight of an upper middle class suburb of Atlanta, which has suffered from numerous foreclosures:

> "If you're like most homeowners, you've probably never given much thought to whether your neighbors pay their mortgages on time. You've got enough to worry about.
>
> Dannice Clark was like that. She'd skip newspaper articles about the trouble with "subprime" loans for people with risky credit. While fixing dinner, she'd tune out TV reports on how subprime defaults are accelerating the nationwide pace of foreclosures. Why should she care? She had a fixed-rate loan on a 5,000-square-foot home with two kitchens in Waters Edge, an upscale subdivision in Stone Mountain, just outside Atlanta.
>
> Here's why: Clark has been trying to sell her home for nearly five months and hasn't had one offer — even after cutting the price to $334,900 from $359,000. The problem is that her street is dotted with four foreclosed homes that lenders are trying to unload for less money.
>
> 'It's truly affecting the sale of my house,' says Clark, 45, who works for the U.S. Postal Service. 'Why pay full price for my house when you can pick up a foreclosure for $30,000 or $40,000 less?'
>
> And as thousands of homeowners across the nation are learning, it's not only home values that are being affected by the foreclosure crisis. When foreclosures rise, as they have in Waters Edge and other middle-class areas amid the meltdown of the subprime mortgage market, they can unravel the social fabric and reshape neighborhoods.
>
> The crime rate can rise while the quality of the schools goes down. Homeowner associations can see their treasuries drained. Nearby businesses close their doors, and local tax revenue suffers."[27]

D. Wider economy.

This change imposes no cost on taxpayers, and does not create a moral hazard by bailing out investors with public money.

By preventing so many foreclosures, it will improve the finances of local municipalities, the entities that lose property tax revenue and bear expenses associated with vacant properties and blight. One study in the Chicago metro area found that each foreclosure costs the municipal governments in police, fire and code enforcement expenses more than $30,000, according to the Homeownership Preservation Foundation.[28]

Some will argue that allowing loan write-downs in bankruptcy might hurt the already fragile home mortgage market. There are two possible effects to analyze: whether lenders will be less willing to extend credit, particularly for high LTV loans, and whether the conventional mortgage market might be more prone to liquidity freeze-ups.

The first response is that the bankruptcy remedy is a very targeted response. Bankruptcy involving one's home is a last resort for almost all families. The family's credit is damaged, though arguably less than it would be from foreclosure. Chapter 13 is not an “in and out” procedure, but rather, a three to five year ordeal. Bankruptcy for three to five years is “major surgery” for a family, not a cosmetic procedure. We hope that this chapter 13 remedy will salvage homeownership for 600,000 families. While this is a significant impact on the current foreclosure epidemic, this result is still just 0.6% of all households and 1.4% of all homeowner households with outstanding mortgages, and we believe that most of these households will not in the end need to go through bankruptcy, but will instead receive a voluntary modification that will serve the lender better economically than a foreclosure.

While the after-inflation value of homes is projected to fall over the next two years, mortgage lenders focus primarily on nominal house prices when deciding whether to make a loan. 2007 will likely be the first year in the last 60 years that the country has seen an actual decline in home prices nationwide, and is projected to fall by approximately 3%. The Federal Reserve, with its recent aggressive rate cut, has shown its determination to prevent actual house deflation as occurred during the early 1930s. Chairman Bernanke's professional interest in and writings about the Great Depression, predating his tenure as Federal Reserve Chairman, argue that home deflation will be a focus of the Federal Reserve. For safety and soundness reasons, and for the protection of homeowners, lenders *should* be very cautious and prudent when making high LTV mortgage loans during periods of stable or slightly declining home prices. This result is a good one and will occur regardless of whether loans are able to be modified in bankruptcy.

Lenders will pull back more than necessary for prudent lending practices only if borrowers are able to “game” the system. This result could hypothetically occur by a borrower who takes a 100% loan against a home in an area where the borrower expects a price decline. This would enable a calculating borrower to plan to file a year later for a five-year chapter 13 bankruptcy, and thereby gain a 3% modification in the loan amount. Just stating the hypothetical demonstrates how far-fetched this scenario is. Presuming that tens of thousands of borrowers will have better ability than bankers/lenders to predict future real estate price declines is implausible. And even then, those borrowers would have five years of intrusive financing management under supervision of a bankruptcy judge.

The spillover effects of concentrated foreclosures pose a much more real risk to freezing up local housing markets in states like California, Florida, Ohio, Nevada, Arizona, and the 42 other states where foreclosures are up significantly over the past year, than this change to the bankruptcy code.

Lending experience during the fifteen years in which bankruptcy courts were modifying mortgage loans on primary residences belies some lenders' claim that allowing such modifications would negatively impact the cost or availability of credit. For the first fifteen years after the enactment of the 1978 Bankruptcy Code, numerous bankruptcy courts around the country believed that they had the authority even as to mortgages on primary residences to “strip down” under-secured mortgage liens to the value of the mortgaged property, and during this period, such mortgages were thus repeatedly written down to the value of the mortgaged home. This practice ended with *Nobleman* in 1993.

During this fifteen year period, there was no suggestion that the cost or availability of credit for mortgages on primary residences was negatively impacted in those jurisdictions whose courts allowed strip-downs, either as compared with other jurisdictions, or as compared with lending experience before strip-downs were permitted or after *Nobleman* brought the practice to an end.[29]

This provision’s Supreme Court formalization in 1993 led to the introduction of abusive 125% LTV loans, as formerly unsecured lenders recognized that if they attached these loans to the house, they would be favored against other unsecured lenders in chapter 13. This was not a good outcome, since these were loans that families could not escape.[30]

The claim that allowing modifications of home mortgages will adversely impact the cost or availability of credit is similarly belied by the past thirty years of experience, in which bankruptcy courts have been modifying mortgage loans on family farms, investment properties, vacation homes and commercial real estate, with no ill effects on credit in those submarkets. That we have robust financing markets for rental property, vacation homes, land lots, family farms, RVs and boats, all of which permit loan modifications in bankruptcy, is strong evidence that the proposed change will not have negative consequences.[31]

Conclusion

Deleting the provision that exempts, alone, the mortgage on a principal residence from being modified in chapter 13 bankruptcy is the only thing that Congress can do to materially reduce the coming wave of foreclosures. Doing so will benefit 600,000 families who will not lose their houses because of chapter 13 modifications, or more likely, voluntary modifications; neighbors will save $72.5 billion of wealth by foreclosures avoided; lenders will receive no less than they would have received through foreclosure; and the national economy will be stronger.

Appendix A – Homeowner savings

US Estimates

Row	Measurement	Year 2004	2005	2006	1Q-2Q 2007
a	Projected Foreclosures	16%	19%	19%	19%
b	Probability of ARM	87%	93%	92%	80%
c	Probability of FRM	13%	7%	8%	20%
d	Probability of Foreclosure Given ARM	16%	20%	20%	20%
e	Probability of ARM Given Foreclosure	91%	95%	94%	85%
f	Probability of Shock	98%	97%	97%	97%
g	Probability of Outstanding	21%	57%	72%	99%
h	Proportion that could be helped (% Original Cohort)	3%	10%	13%	15%
i	Original cohort	2,219,547	3,259,908	3,219,749	1,093,105
j	Estimate of eligible homeowners	64,960	335,260	413,237	169,041
k	Total eligible	982,498			
l	% of outstanding borrowers	14%	18%	18%	16%
m	Total % of outstanding borrowers	17%			
n	Less expected modifications (10%)	6,496	33,526	41,324	16,904
o	Less economically unviable (25%)	16,240	83,815	103,309	42,260
p	Net potential help	42,224	217,919	268,604	109,877
q	**Net total potential help**	**638,624**			
r	Net potential help as % outstanding borrowers	9%	12%	12%	10%
s	Net total potential help as % of outstanding borrowers	11%			
	Chart Data	All	All Count	FC only	FC Count
	Loans not projected to foreclose	81.5%	7,979,097		
	Projected foreclosures completed or fixed rate	8.5%	830,714	45.8%	830,714
	Projected foreclosures that cannot be helped	3.5%	343,874	19.0%	343,874
	Population that could be helped	6.5%	638,624	35.2%	638,624

Row	Measurement	Source
a	Projected Foreclosures	CRL, Losing Ground report, 2007 assumed
b	Probability of ARM	Fannie Mae, Bloomberg
c	Probability of FRM	Fannie Mae, Bloomberg
d	Probability of Foreclosure Given ARM	UNC research, calculation
e	Probability of ARM Given Foreclosure	Calculation
f	Probability of Shock	HMDA, Federal Reserve H.15
g	Probability of Outstanding	Bloomberg
h	Proportion that could be helped (% Original Cohort)	Product of rows a, e, f, g
i	Original cohort	CRL, Losing Ground, Net Drain reports, Inside B&C Lending
j	Estimate of eligible homeowners	Calculation
k	Total eligible	Calculation
l	% of outstanding borrowers	Calculation
m	Total % of outstanding borrowers	Calculation
n	Less expected modifications (10%)	10% estimate from Moody's 7/12/07 conference call
o	Less economically unviable (25%)	25% assumption

We estimate that the proposed changes potentially could help 638,000 homeowners stave off foreclosure arising solely from a subprime adjustable-rate mortgage with a large payment shock. This estimate is net of borrowers who are expected to receive loan modifications (10%) and those who are expected to fail in any event (25%). This document details the logic, assumptions, and calculations made to arrive at this estimate.

We begin with our estimate of total projected foreclosures for each subprime loan vintage (i.e., annual cohort) in row a. The projections from 2004-2006 are based on our "Losing Ground" report, issued in December 2006. The 2007 figures reflect an assumption that the projected foreclosure rate for this vintage will follow that for 2006. This assumption is based on (1) observations of securitized loan deals brought to market in 2007 showing that loan origination quality has not improved markedly and (2) continued concerns about the strength of the housing market.

Next, in row e, we calculate the proportion of all projected foreclosures that are expected to be adjustable-rate mortgages (ARMs) based on (1) ARM market share (row b) and (2) elevated risk that ARMs will experience foreclosure, based on published research from the University of North Carolina.

Next, in row f, we analyze Home Mortgage Disclosure Act (HMDA) data to arrive at an expectation for the proportion of ARM loans that will experience significant payment shocks at reset. Here, the test for significant payment shocks are that the new payment will be greater than 50% of the original reported borrower income and will be 10% above the original payment burden. Since HMDA data does not contain key information, to arrive at an "average" expectation, we assume all loans are ARMs with 30 year terms, carry a typical start rate, and a typical margin. Using HMDA-reported borrower incomes and loan amounts, we then reach the reported figures. For 2007, we assume the figure will follow 2006.

Next, in row g, we observe the proportion of securitized loans from each year that are still outstanding through market data on subprime mortgage backed securities on Bloomberg.

We then multiply rows a, e, f, g (foreclose % * % ARM given foreclosure * % outstanding * % with expected payment shock) to arrive at our estimate of borrowers who are "eligible" for help: that is, current borrowers with a subprime ARM projected to end in foreclosure and carrying a large built-in payment shock.

From here, we discount the estimate to take into account expectations for borrowers who will receive loan modifications from lenders (row n) and borrowers who are likely to fail in any event (row o).

Appendix B – Evaluation of HR 3609

Rep. Miller has introduced the Emergency Home Ownership and Mortgage Equity Protection Act of 2007, which is co-sponsored by two members of this Subcommittee, Chairman Sánchez and Rep. Watt, as well as Reps. Frank and Maloney. CRL is strongly supportive of HR 3609; it directly addresses the lack of ability for judges to modify mortgages on a principal residence and will provide substantial help to struggling homeowners, neighbors, and the economy as a whole.

In addition to the chapter 13 modification provision that is the subject of this testimony, CRL strongly supports these provisions from Rep. Miller's bill:

1. Amortization after the plan. Without enabling the mortgage to be amortized beyond the end of the plan, the proposal would not be effective. We propose that the period of amortization be 30 years, less the number of years that the borrower has been in the house.

2. Protection against abusive fees. This provision would require lenders to give notice of fees levied, provide debtors a chance to object, and, if required, give the court the ability to determine the fee's reasonableness. Abusive fees are so significant a problem that they have seriously undermined chapter 13 mortgage relief, even for debtors who complete their plans. Lenders often add unauthorized or excessive fees to accounts, without telling the debtor or the court. Examples include attorney's fees, even for litigation the lender lost, often far in excess of reasonable amounts for standard form motions; fees for numerous "property inspections"; late fees that are improper because chapter 13 payments are misapplied by lender software, and other junk fees. Many debtors find out about the fees only after the bankruptcy case is over. In many cases they thought they had resolved their mortgage problem, only to find themselves two or three months behind again because payments were applied to the fees. Otherwise, they often do not find out until they go to refinance or sell, and the fees are demanded at closing, when debtors are under tremendous pressure to pay them so the closing goes through.

3. Waiver of credit counseling. Credit counseling is a useful tool for a family having financial difficulties, but a debt management plan will not help a family facing imminent foreclosure; it is far too late for that. It can only waste money and time, both of which are in scarce supply in such a situation. The GAO questioned the utility of credit counseling in any event.

CRL also supports the addition of three other provisions.

1. Homestead exemption for people over 55 for purposes of bankruptcy. Many older Americans have more equity in their home than a state's low homestead exemption permits, but have a mortgage loan with an unaffordable or exploding interest rate. This provision would enable a judge to recast the interest rate in a bad loan so the older borrower can keep his or her house in a state with a low homestead exemption.

Without a homestead floor, older Americans with just a bit more equity in their house than the state homestead exemption ($20,000 in North Carolina for a single person, for example) must pay the amount of this “nonexempt equity” to pay off unsecured creditors in chapter 13, which generally requires selling their house because they don’t have liquid assets of this amount. So someone with $30,000 in equity in NC could not utilize the chapter 13 modification provision and save their house without this change.

The provision is consistent with the 2005 amendment adding section 522(b)(3)(C) and (d)(12) that protect pension rights for all debtors, no matter which set of exemptions they utilize. That is because, for many older homeowners, their life savings are in their home equity. The $75,000 amount protected is, in fact, very modest compared to the pension benefits that can be protected.

2. Resolution of disputes. The majority of circuits hold that bankruptcy judges have the discretion to hear all “core proceedings” that are integral to the bankruptcy case, such as claims and defenses raised as objections by the debtor. This is because bankruptcy is a collective proceeding, and the bankruptcy court can consider all interests better than an arbitrator with only two parties before him; applicable mandatory arbitration would govern “non-core” claims. A minority of circuits have found otherwise, however, insisting that all disputes be arbitrated, even the question of whether a creditor violated a bankruptcy stay. This will delay the resolution of disputes and frustrate the ability of the court to treat all creditors equally. We recommend that Congress adopt the majority view.

3. Preservation of consumer protection claims in bankruptcy. It would appear to be common sense, and is the majority rule, that a consumer protection claim that a borrower has against their lender is available to be pursued until the statute of limitation runs, or for some claims, when the sale of the house occurs. However, a minority of courts have held that a foreclosure judgment wipes away these claims. That is so even if the claim is that a lender committed fraud to convince a borrower to take out an abusive mortgage, which caused the foreclosure. This provision would simply clarify that the debtor can still raise consumer protection claims in bankruptcy even if there has been a foreclosure judgment entered against him or her, which is common since families often only declare bankruptcy after this judgment has been obtained.

Appendix C – Foreclosure Timelines

State	Sale Held	Confirmation of Sale	Redemption Period	Minimum estimated time complete sale	Maximum estimated time complete sale
AL	49-74 (days)		365 days	414	439
AK	105-108		365 days *	105	473
AR	80		365 days*	80	445
AZ	102		30-180 days*	132	282
CA	117-120		365 days*	117	485
CO	91		75 days	166	166
CT	court decides	3-4 weeks	court decides	court decides	court decides
DC	75-90		None	75	90
DE	170-210	200-300	None	370	510
FL	135		None	135	135
GA	37		None	37	37
HI	160-220	195-260	None	355	480
IA	160		20-365 days	180	525
ID	150		365 days	515	515
IL	300		90 days	300	390
IN	251		None	251	251
KS	130		3-12 mos	220	495
KY	147	3 weeks	1 year	533	533
LA	180-240		None	180	240
MA	75		None	75	75
MD	46	30-60	court decides	court decides	court decides
ME	240		90 days	330	330
MI	60		30 days - 1 yr	90	425
MN	90-100		6-12 months	270	465
MO	50-60		20 days - 1 year	70	425
MS	90-115		None	90	115
MT	160-170		0-1 year	160	535
NC	110		10 days	120	120
ND	150		6 mos - 1 year	330	515
NE	120-180	0 or 2-3 weeks	None	120	201
NH	65		None	65	65
NJ	270		10 days	280	280
NM	180		1-9 mos	210	450
NV	116		None	116	116
NY	299-445		None	299	445
OH	217		depends on county	depends on county	depends on county
OK	156	30		186	186
OR	150		180 days *	150	330
PA	270	10	None	280	280
RI	75		120	195	195
SC	150		0-30	150	180
SD	150		60- 365 days	210	515
TN	60		0-730 days	60	790
TX	21		None	21	141

UT	138		court decides	138	138
VA	45-60		240 days*	45	300
VT	0-7 mos	10 days	180- 365 days	190	585
WA	135		365 days*	135	500
WI	290		60-365 days	350	655
WV	120		None	120	120
WY	60	0	90- 365 days	150	425
				Longest wait time	**790**
				Median maximum wait time	**360**

Source: www.stopforeclosure.com -click on United Stated Foreclosure Laws (View FC By State)
Source: http://www.realtytrac.com/foreclosure_laws_overview.asp (FC Chart at the bottom)

1 As Alan Greenspan recently told Newsweek, “[Y]ou had Wall Street's securitizers basically then talking to the mortgage brokers saying, 'We'll buy what you've got.'. The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime-loan market would have been very significantly less than it is in size.” From "The Oracle Reveals All," Newsweek, pp. 32, 33 (Sept. 24, 2007).

2 Inside B&C Lending (Sept. 1, 2006); see also Inside Mortgage Finance – MBS Database, 2006.

3 Credit Suisse, Mortgage Liquidity du Jour: Underestimated No More, March 12, 2007, p. 6.

4 Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest , Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners, (December 2006) at http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=31214551. A recent study by the investment bank, Lehman Brothers, shows that the number of 2006-originated loans likely to face foreclosure is 30 percent. Mortgage Finance Industry Overview, Lehman Brothers Equity Research, p. 4 (December 22, 2006).

5 Foreclosure filings on subprime mortgages now account for over 60 percent of new conventional foreclosure filings reported in the MBA National Delinquency Survey. This fact is striking given that only 23 percent of recent originations were subprime, and subprime mortgages account for only 13 percent of all outstanding mortgages.

6 Donald R. Haurin and Stuart S. Rosenthal, The Sustainability of Homeownership: Factors Affecting the Duration of Homeownership and Rental Spells, p. 43 HUD
Office of Policy Development, (December, 2004), at http://www.huduser.org/Publications/pdf/homeownsustainability.pdf.

7 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 neighborhood cost/foreclosure * 2.2 million foreclosures = $265.8 billion in lost wealth. http://www.realtor.org/Research.nsf/files/MSAPRICESF.pdf/$FILE/MSAPRICESF.pdf

8 See, e.g., Nicola Clark, “Bank in Germany Posts Loss Because of Bad Stock Trades,” New York Times (August 31, 2007); Jenny Anderson and Heather Timmons, “Why a U.S. Suprime Mortgage Crisis is Felt Across the World,” New York Times (August 31, 2007). Indeed, the globalization of the consequences have left people on other continents asking for an international oversight role: “Why should the rules of lending in the U.S. be left to U.S. regulators when the consequences go everywhere?” Heather Timmons and Katrin Bennhold, “Calls Grow for Foreigners to Have a Say in U.S. Market Rules,” New York Times C1, (August 29, 2007).

9 Source : Bank of America analyst, cited by Orange County Register http://blogs.ocregister.com/mortgage/archives/2007/06/bofa_analyst_mortgage_correcti_1.html

10 “Rising Early Payment Defaults Threaten to Inflict Further Problems on Alt A Lending,” Inside Mortgage Finance 7/6/07.

11 Through the second quarter of 2006, hybrid ARMs made up 81 percent of the subprime loans that were packaged as investment securities. That figure is up from 64 percent in 2002. (Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs, p. 2 Fitch Ratings Credit Policy (August 21, 2006)).

12 See e.g., Gretchen Morgenson, Crisis Looms in Market for Mortgages, The New York Times (March 11, 2007).

13 See the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, http://www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm; Homeownership Preservation Summit Principles, Sen. Chris Dodd, http://dodd.senate.gov/index.php?q=node/3870; Fitch Ratings, "Residential Mortgage Loss Mitigation Strategies," Oct. 14, 2003.

14 White House press release, August 31, 2007. See also the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, which encourages servicers to use their authority to pursue loss mitigation strategies wherever possible, including loan modifications.

15 See generally "Modified Mortgages: Lenders Talking, Then Balking," San Francisco Chronicle, 9/13/07; Jim Wasserman, "Foreclosures stack up: Frustrated borrowers who lenders to try to work things out say it's a fruitless ordeal," Sacramento Bee, 9/2/07; "Tangle of Loans Feeds Foreclosure Crisis," The Boston Globe, 7/3107 http://www.boston.com/business/personalfinance/articles/2007/07/31/tangle_of_loans_feeds_foreclosure_crisis/.

16 Michael P. Drucker and William Fricke , Moody's Investors Service, Moody's Subprime Mortgage Servicer Survey on Loan Modifications, September 21, 2007 ("Based on the survey results, Moody's is concerned that the number of modifications that will be performed in the future by subprime servicers on loans facing reset may be lower than what will be needed to significantly mitigate losses in subprime pools backing rated securitizations.").

17 Credit Suisse, Mortgage Liquidity du Jour: Underestimated No More, March 12, 2007, p. 5.

18 Bob Ivry, "Subprime Borrowers to Lose Homes at Record Pace as Rates Rise," Bloomberg.com (September 19, 2007).

19 Moody's Economy.com, "Into the Woods: Mortgage Credit Quality, Its Prospects, and Implications," a study incorporating unique data from Equifax and Moody's Investors Service (2007).

20 In 2005, the bankruptcy law was amended to treat some recent purchase money loans for automobiles in a similar fashion, but the dollar figures for such loans pale in comparison to the amount of a home loan and, depending on fair market value, the amount of equity associated with the residence. Moreover, such loans can still be modified with respect to interest rate and payment amounts.

21 Grubbs v. Houston First American Sav. Ass'n, 730 F.2d 236, 242-43 (5th Cir. 1984).

22 See Grubbs, 730 F.2d at 246 (discussing the legislative history of the modification provision of the 1978 Bankruptcy Code).

23 Prior to 1992, when the Fifth Circuit rendered the decision that was affirmed by the Supreme Court in Nobleman, every circuit court of appeals that considered the issue -- there were four all together -- permitted mortgages on primary residences to be stripped down to the value of the mortgaged property, although district courts around the country were split on the issue. The four circuit court decisions were In re Bellamy, 962 F.2d 176 (2nd Cir. 1992); In re Hart, 923 F.2d 1410 (10th Cir. 1991); Wilson v.

Commonwealth Mortgage Corp., 895 F.2d 123 (3rd Cir. 1990); and In re Hougland, 886 F.2d 1182 (9th Cir. 1989). The basis for these decisions was the courts' view that § 1322(b)(2) permitted bankruptcy courts to bifurcate under-secured homestead mortgages between the portion that was secured and the portion that was not. See Nobleman, 508 U.S. at 327 n. 2.

24 The family farm chapter 12 corollary to section 1322(b)(2), found at 11 USC § 1222(b)(2), provides the bankruptcy court with power to "modify the rights of holders of secured claims, or of holders of unsecured claims…" Similarly, the corresponding provision of chapter 11, found at 11 U.S.C. § 1123(b)(5), contains language identical to that in section 1322(b)(2), reaffirming the exemption for loans secured by the debtor's primary residence, but imposes no corresponding exemption for a company's principal place of business or any other property.

25 See Homeownership Preservation Summit Principles, Sen. Chris Dodd, http://dodd.senate.gov/index.php?q=node/3870; the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, http://www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm; Fitch Ratings, "Residential Mortgage Loss Mitigation Strategies," Oct. 14, 2003.

26 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

27 Noelle Knox, "Rising foreclosures reshaping communities," USA TODAY, 4/07, A1
http://www.usatoday.com/money/economy/housing/2007-04-12-foreclose-cover-usat_N.htm

28 Id.

29 We at CRL gathered data from the United States Census Bureau and the Federal Housing Finance Board to assess the impact of strip-downs on both home ownership rates and mortgage interest rates. Every year, the Census Bureau estimates population and home ownership rates for the fifty states and the District of Columbia. And each month the Federal Housing Finance Board conducts a survey known as the Monthly Interest Rate Survey, or MIRS. The MIRS tracks rates and terms on conventional mortgage loans. CRL gathered and reviewed the Census and MIRS data from 1984 to 2000. We assumed that fewer families could purchase and own homes if mortgages became scarce or prohibitively expensive. The data show that allowing strip-downs had no appreciable impact on the cost of credit or the rate of home ownership.

30 The high loan to value loan market grew from $1 billion in 1995 to $8 billion in 1997 and was expected to be around $12 billion in 1998. http://www.fdic.gov/bank/analytical/regional/ro19991q/na/infocus1.html.

31 While it is true that rates are higher on investment properties, this is entirely due to the increased credit risk associated with such a loan (an owner-occupier has to live somewhere, and the amount that otherwise would have gone to rent can contribute to their mortgage; if they cannot find a tenant for an investment property and have no additional resources, their chances of default are greater) For example, Genworth Mortgage Insurance's "A-Minus Rate Sheet" dated December 1, 2005 shows a 0.5% premium for investor loans added to a base rate of 1.66% annually for coverage on a 90% LTV A minus loan with a credit score of 600-619.