TESTIMONY OF

DAVID M. CERTNER

LEGAL COUNSEL AND LEGISLATIVE POLICY DIRECTOR

AARP

BEFORE THE

HOUSE COMMITTEE ON THE JUDICIARY

ON

H.R. 200—"HELPING FAMILIES SAVE THEIR HOMES IN BANKRUPTCY ACT of 2009" and H.R. 225—"EMERGENCY HOMEOWNERSHIP AND EQUITY PROTECTION ACT"

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For further information
Contact: Dean Sagar
Government Relations and Advocacy
(202) 434-3800

Chairman Conyers, Ranking Member Smith, and Members of the Judiciary Committee, I appreciate the opportunity to appear before the Committee this afternoon on behalf of AARP. I am David Certner, Legislative Counsel and Legislative Policy Director for AARP. With 40 million members, AARP is the nation's largest organization representing the interests of Americans age 50 and older and their families.

As Congress begins work this week on broad economic recovery legislation to revive our nation's economy, it is important to remember that the underlying cause of our nation's economic crisis is the huge number of mortgage loans currently delinquent or in foreclosure. The impact of record numbers of foreclosures is felt not only by individual families, but by neighborhoods, entire communities and the economy as a whole. We cannot address the broader economic crisis without first resolving the current foreclosure crisis. Families need help to stay in their homes, and communities need to be stabilized, before the economy can start growing again.

Home foreclosures today are at an all-time high and are projected to go even higher. Various estimates place the number of homes already lost to foreclosure at between 1.2 and 1.5 million. Another two million households with subprime mortgages are currently delinquent and in danger of losing their homes in the near future. A December 2008 Credit Suisse report estimated that foreclosures for all types of mortgages could exceed 8 million by the end of 2012—the equivalent of 1 foreclosure for every 6 U.S. households with mortgages.

The Foreclosure Crisis and Older Americans

The prospect of widespread foreclosures is particular serious for older Americans who depend on their homes not only for shelter, but as their primary asset for retirement. For Americans age 50 and over, losing a house represents a significant financial loss from which there is limited time to recover, and for many recovery may be impossible given their age and limited income.

There is ample evidence to suggest that the foreclosure crisis has included many older homeowners among its victims. Older homeowners, many of whom live on limited incomes while having significant equity in their homes, have been targeted by unscrupulous lenders and brokers since the early stages of the subprime boom with offers of questionable home repair loans, second mortgages and home refinancing. We also know that far greater numbers of older persons are carrying substantial mortgage debt into retirement. According to Harvard's Joint Center for Housing Studies, 53 percent of homeowners age 50 and older are entering retirement with mortgage debt, nearly double the number of just two decades ago.

Until recently, however, no data has existed to document how many older homeowners may be affected. Traditional sources of housing and mortgage information, including Home Mortgage Disclosure Act and Mortgage Bankers Association data, have not included an age variable. To quantify and understand the impact of the mortgage crisis on older Americans, AARP purchased data from Experian, one the three major U.S. credit bureaus. Experian's database contains information on 49.9 million consumers with first mortgages on residential, vacation and investment properties, representing about 80 percent of all first–lien residential mortgages outstanding. This data includes variables on age, credit score, income, loan-to-value,

ethnicity, marital statutes and other credit and demographic variables, as well as information on prime and subprime loans.

AARP's Public Policy Institute analyzed a 2.5 million person random sample of Experian's larger database that included information on nearly 1 million homeowners over age 50. The data covered a six-month period ending December 31, 2007, a period in which interest rates were still rising and home values were only beginning to decline. The resulting report, "Older American and the Foreclosure Crisis," includes a number of important findings:

- Americans age 50 and over hold about 41 percent of all first mortgages.

- More than 684,000 homeowners age 50 and over were either delinquent or in foreclosure at the end of 2007, representing 28 percent of delinquencies and foreclosures.

- African-American and Hispanic homeowners over age 50 experienced higher rates of foreclosure than Caucasian homeowners in all age groups, and roughly double their rate of homeownership:

  - Older African-American homeowners held 6.8 percent of all first mortgages, but represented 14.4 percent of all foreclosures;

  - Hispanic homeowners age 50 and older held 7.5 percent of first mortgages, but represented 15.9 percent of all foreclosures.

- Having a subprime loan was found to be associated with higher foreclosure rates for all age groups, but the impact of subprime lending was disproportionately greater for older homeowners:

  - Homeowners age 50 and older with subprime first mortgage loans are nearly 17 times more likely to be in foreclosure than homeowners of the same age with prime loans; homeowners under age 50 were 13 times more likely to be in foreclosure with subprime loans;

  - Older homeowners with subprime loans are 13 times more likely to be seriously delinquent in their mortgage payments than comparable homeowners with prime loans; for homeowners under age 50, a multiple of 9 times are seriously delinquent.

- Homeowners age 50 and older with loan-to-value ratios of 100% or greater experienced foreclosure rates nearly double the national foreclosure rate for all older homeowners.

This last finding is significant when you consider data from the American Housing Survey for 2006 showing some 2.3 million households with a head of household age 50 or older having less than 20 percent equity in their homes. Since 2006, home prices have fallen 20 percent nationwide and are projected to decline by at least another 10 percent during 2009. This means that even higher percentages of older homeowners will be included among the millions of homeowners facing foreclosure and loss of retirement security in coming years.

Current Mortgage Modification Efforts are Inadequate

Congress has taken two important actions to help address the foreclosure crisis. In August it enacted the HOPE for Homeowners program, as part of the Housing and Economic Recovery Act, to allow homeowners with subprime mortgages facing higher scheduled payments to refinance with lower-rate, FHA-insured fixed rate mortgages. In the Emergency Economic Stabilization Act in October, Congress authorized a Troubled Asset Relief Program (TARP) to help restore confidence and stability in our housing market and expand access to credit. It also directed the Treasury Secretary to "implement a plan" to encourage modification of loans acquired by Treasury and other financial regulators to provide long-term affordability for distressed homeowners.

To date, the Treasury Department has largely ignored Congress' directive to facilitate mortgage modifications and has sought to implement a TARP program that focuses primarily on recapitalizing financial institutions and restoring investor confidence. Whatever systematic efforts have been made to help individual borrowers avoid foreclosure have been largely voluntary by lenders and servicers both under the framework of the HOPE for Homeowners program and financial industry initiatives such as the HOPE NOW Alliance.

Available data suggests that these voluntary efforts have been inadequate, both in the numbers of mortgages modified and the level of relief provided to homeowners. HUD reports that fewer than 1,000 lenders or servicers have filed applications with the FHA on behalf of borrowers seeking relief under the HOPE for Homeowners program. The requirement that lenders reduce loan principal to 90% of the home's current appraised value represents a significant up-front loss that few lenders appear willing to assume voluntarily. Industry efforts at voluntary loan modification have not fared much better. Credit Suisse reported in October that only 2.5 percent of delinquent subprime mortgages received modification during the prior month. The Working Group of Attorneys General and Banking Commissions reported similar data showing that nearly eight out of ten seriously delinquent homeowners were not on track to receive any form of loan modification.

Most of the voluntary modifications that have occurred involve changes in interest rates for adjustable rate loans that include freezing rates at current levels, or not fully resetting rates to the full indexed rate. Most HOPE NOW loans also include repayment plans that typically require homeowners to add previously unpaid debt to their current loan payments. These modifications do little to actually improve the borrower's financial condition. Professor Alan White of the Valparaiso School of Law analyzed a large sample of HOPE NOW loan modifications and found that nearly half (45 percent) the modifications actually increased the homeowner's monthly payments, while another 20 percent left the payments virtually unchanged. The result has been loan modifications in which relief for the homeowner has been temporary or unsustainable. Research conducted by the Office of the Comptroller of the Currency (OCC) found that 58 percent of borrowers who received loan modifications in the first quarter of 2008 had subsequently missed at least one monthly payment, while 51 percent of borrowers receiving loan modifications during the second quarter had already missed payments by December 2008. These findings closely track data reported by Credit Suisse showing that 33% of the loans modified during the third quarter of 2007 were seriously delinquent ten months after modification.

Barriers to Meaningful Mortgage Modification

The high default rates found by the OCC and Credit Suisse confirm that the majority of voluntary mortgage modifications have not included the type of significant reductions in interest rates or loan principal needed to make loans affordable for borrowers. An October 2008 report by Credit Suisse found that modifications involving rate reductions and reduced principal had redefault rates of less than half that of traditional modifications involving only repayment plans, extended loans terms or rate freezes. With a 23 percent redefault rate, Credit Suisse concluded that the post-modification performance of reduced principal loans "is materially better than that of other more traditional modifications," particularly in light of the fact that 80 percent of these loans had been delinquent prior to modification. As the number of borrowers having negative equity continues to increase, Credit Suisse observed "a growing need" for reduced principal modifications that "not only reduce the monthly payment, but also reduce borrower's negative equity, thereby increasing their willingness to stay in the home."

A number of obstacles have tended to limit the willingness of lenders and servicers to engage voluntarily in loan modifications involving meaningful reductions in mortgage principal and/or loan interest rates. The fact that most mortgages are combined in mortgage securities that are sold to many investors makes it more difficult to obtain the consent of all owners to make significant modifications. Loan servicers are hesitant to modify mortgages in ways that may cause disproportionate losses for certain classes of investors for fear of investor lawsuits. Mortgages with second liens also present obstacles to loan modification, either because the subordinate loan is already in default, or holders of the second lien refuse to absorb losses to benefit first lien holders. In addition, the compensation system for loan servicers, which provides payment for foreclosures but not loss mitigation, creates a built-in bias against engaging in more labor-intensive loan modifications.

These obstacles help explain why the spreading foreclosure crisis cannot be resolved through voluntary efforts by the financial services industry. A mechanism is needed to enable courts to implement economically rational loan modifications where mortgage lenders or servicers are unwilling or unable to do so. Court-supervised loan modification through the bankruptcy courts offers quick and effective relief for millions of homeowners at risk of losing their homes. And it can accomplish this without significant added cost to taxpayers.

Why AARP Supports H.R. 200 and H.R. 225

AARP supports H.R. 200, the "Helping Families Save Their Homes in Bankruptcy Act of 2009," and H.R. 225, the "Emergency Homeownership and Equity Protection Act," and urges Congress to enact the broadest possible bankruptcy reform provision as part of the economic recovery legislation. Both proposals seek to remove the current prohibition in Sec. 1322 of the Bankruptcy Code against modification of primary residential mortgages in Chapter 13 proceedings.

Currently, judicial modification of loans in bankruptcy is available for owners of commercial properties, investment properties, vacation homes, yachts, family farms and other securitized property, yet it is denied to struggling homeowners to protect the home they live in. Eliminating this exception to the Bankruptcy Code would create a number of immediate and important benefits:

- It would allow bankruptcy judges to cut through the various obstacles that have doomed loan modifications from being successful, even by the most proactive mortgage services;

- It would provide a process for loan modification that recognizes all debts a household is facing and provide sensible loan workouts that will be affordable and sustainable;

- It provides a process in which the legitimate interests of lenders, servicers and investors are recognized and where all parties can realize greater returns than in foreclosure;

- It would stimulate greater numbers of voluntary mortgage modifications, creating an incentive for lenders and servicers to work with borrowers rather than have bankruptcy judges do it for them.

A clear precedent exists for providing this relief to homeowners. Congress enacted a similar measure in response to the farm crisis of the 1980s when an economic downturn and depressed land values were pushing thousands of family farmers into foreclosure. The Family Farmer Bankruptcy Act of 1986 removed a similar restriction in Chapter 12 of the Bankruptcy Code that prevented bankruptcy judges from modifying mortgages on family farms that included their primary residences. This change proved so effective in helping farmers through the crisis that it was made a permanent part of the Bankruptcy Code in 2005.

Claims by the financial services industry that allowing judicial modification of residential loans will adversely affect the cost or availability of mortgage credit can be easily countered not only by the courts' experience in modifying loans on family farms under Chapter 12, where no adverse cost impact occurred, but also in the bankruptcy courts' prior experience in modifying loans on primary residences under Chapter 13. Between 1978 and 1993, numerous bankruptcy courts modified mortgages on primary residences by placing the portion above the market value of the house on par with other unsecured debts. The financial services industry has produced no evidence to show there was any adverse effect on the cost or availability of credit for mortgages on primary residences, either as compared to other court jurisdictions that did not allow such modifications during this period or as compared with mortgage lending in the same jurisdictions after 1993.

In addition, H.R. 220 and H.R. 225 provide a number of limitations on loan modifications to ensure adequate protection of the interests of lenders, investors and servicers. Bankruptcy relief is available only to homeowners who would otherwise lose their home in foreclosure and who have sufficient means to sustain a market rate mortgage. H.R. 225 also limits loan modification only to mortgages made before the bill is enacted. Both bills place limits on key terms of loan modifications—requiring that interest rates be set at commercially reasonable, market rates, that loan terms not exceed 40 years, and that principal balances not be reduced below the value of the property. Finally, a bankruptcy judge must be satisfied that a homeowner is acting in good faith in seeking mortgage relief.

Conclusion

Mr. Chairman, AARP strongly believes that judicial modification of primary mortgages must be part of any solution to the foreclosure crisis. Continued reliance on voluntary

approaches to loan modification will not adequately address the problem, even if incentives can be provided through TARP or other programs. Chapter 13 bankruptcy offers an existing structure, and an impartial and trusted process, that can help hundreds of thousands of families save their homes. As a matter of basic fairness, it is time Congress provided average homeowners with the same rights and opportunities to protect their primary assets in bankruptcy that corporations, investors, farmers and others have relied on for many years.