Statement of the Honorable Jack Kemp
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Before

The Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

United States House of Representatives

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Chairwoman Sanchez, Ranking Member Cannon, Chairman Conyers and Members of the Committee, thank you for your invitation to discuss the subprime lending crisis facing America and legislation before the House that could help many of the 2.2 million Americans facing foreclosure save their homes. I particularly appreciate the opportunity to reemphasize the importance of the homeownership culture in America, which is why I am supporting the Conyers-Chabot "Emergency Home Ownership and Mortgage Equity Protection Act" as it was amended here in this Committee.

I am very pleased to be here today sitting next to my good friend Wade Henderson and all the other witnesses. It is a pleasure to work with him again as he is a committed advocate for Civil Rights, a real patriot, and I appreciate the invitation you have given us.

Mr. Chairman, I am here not as an expert on bankruptcy jurisprudence, but as a former Member of the House, HUD Secretary, and a long-time advocate for homeownership for all Americans as a tool to strengthen our communities and our economy while building wealth and assets for working families.

Mr. Chairman, I scarcely need to tell you about the role homeownership plays in this society. It embodies the American Dream and represents an invaluable economic asset for millions of families. A strong housing market has been a principal engine for our nation's economic growth, contributing to the development of stable and thriving communities, broadening the tax base, and rising employment opportunities.

Today's housing recession is serious, but in perspective the overall economy is still growing. The subprime mortgage meltdown exists because there was an abundance of liquidity, and soaring property values in many areas of the country, which allowed for exuberant lenders to provide ill-advised subprime loans, particularly unconventional ARM's representing 60% of foreclosures.

The impact of the subprime mortgage contraction is clear in certain areas; lending standards are tightening, subprime lenders are going out of business and the large investment banks are suffering significant losses after huge revenue increases resulting from the housing market. Most importantly, hard working Americans' homes are in jeopardy because the value of their home is less than their actual mortgage.

At the end of last year I was approached by a coalition of consumer advocacy organizations who asked that I consider supporting this bipartisan legislation as it was amended right here in this Committee. As you know, before I served as President Bush's HUD Secretary, I served as a Representative from Buffalo, New York in this Chamber. I know that bipartisanship alone is not the singular ingredient for good policy. However, in this case, I salute you Chairman Conyers, and you Congressman Chabot, and all of the Members of the Committee who supported this legislation, for striking the right balance through negotiation and producing a good bill. I am happy to support it.

When I was HUD Secretary, we fought against economic pessimism every day in the effort to spread the American dream of homeownership, particularly for moderate- and low-income families. Over the last 15 years, homeownership, especially among people of color, has risen to historic levels. In just the last five years, 2.8 million families bought their first homes. Now, the subprime mortgage crisis is threatening to roll back this progress. Experts predict that more than 2.2 million Americans are facing foreclosure as a result of this national crisis.

This bill will have more impact on these home-owning families than any other option currently on the table; I've seen estimates that as many as 600,000 homeowners might be eligible as well as preventing $72.5 billion of wealth being lost by families who are being affected by virtue of their location being near foreclosed homes. According to Mark Zandi, Chief Economist and Co-Founder of Moody's Economy.com, "allowing homeowners access to judicial modification would prevent about one-quarter of foreclosures likely to occur between now and the end of next year – or about 570,000 homes saved." In the absence of modification, many of today's loans will result in foreclosure. Given the severity of this national crisis, allowing judges to modify them in bankruptcy court is the right thing to do. The bill is targeted at only sub-prime and nontraditional mortgages and will be available for only seven years after it is enacted in order to mitigate against the next wave of exploding interest rate resets. I believe it is a narrow, tailored, and appropriate remedy for homeowners and the right thing for Congress to do.

Some lender representatives have claimed that HR 3609 would drive up interest rates and harm the securities market. There may be a legitimate reason why some of the country's biggest banking institutions would oppose this legislation, but those reasons are not it. There is no data that supports the contention that bankruptcy changes being contemplated in Congress would do either. HR 3609, as you well know, applies to existing loans only. Therefore, by definition, it could not affect future interest rates because it would not apply to future loans. While the bill has changed, the talking points against it have not.

In addition, the bill narrowly targets families who would otherwise lose their homes; not only must the borrower lack the income to pay their mortgage, after taking account of Spartan IRS expenditure allowances, but they must actually have received notice from their servicer that foreclosure is imminent. Since the only families who are eligible for relief are those who would have lost their home to foreclosure, the bill adds no new risk to mortgage holders. The loss will be caused not by the chapter 13 provision, but rather by the borrower's inability to repay the debt according to its terms; the alternative to judicial modification isn't full repayment, but nonpayment. Further, the bill guarantees lenders at least the value they would obtain through foreclosure, since a foreclosure sale can only recover the market value of the home, and saves lenders the high cost and significant delays of foreclosures.

There have been decades of experience in which bankruptcy courts have been modifying mortgage loans on family farms in chapter 12, commercial real estate in chapter 11, vacation homes and investor properties in chapter 13, with no ill effects on credit in those submarkets. Debt secured by all of these asset types, in addition to credit cards and car loans, are readily securitizable even though they can be modified in bankruptcy.

As I wrote in a recent LA Times op-ed, bankruptcy law is wildly off-kilter in how it treats homeownership. Under current law, courts can lower unreasonably high interest rates on secured loans, reschedule secured loan payments to make them more affordable and adjust the secured portion of loans down to the fair market value of the underlying property -- all secured loans, that is, except those secured by the debtor's home. This gaping loophole threatens the most vulnerable with the loss of their most valuable assets -- their homes -- and leaves untouched their largest liabilities -- their mortgages.

Examining mortgages during the first eight months of 2007, Moody's Investors Service found that lenders only modified 3.5% of subprime loans that reset to higher levels, compared with industry estimates that up to half of such borrowers facing reset will lose their homes to foreclosure.[i] In addition, recent MBA data show that foreclosures are outstripping modifications 7 to 1; for the subprime ARMs that are the root of the current crisis, foreclosures outnumber modifications 13 to 1. Further, Secretary Paulson's plan for voluntary modifications is welcome, only 3% of subprime ARM borrowers are likely to receive streamlined modification under its terms. Repayment plans, which require a subprime ARM borrower to pay the full 12% interest rate while catching up on delinquent payments at the same time, are ineffective. In the absence of detailed reporting, it is not even clear that the few modifications that have occurred are sustainable. According to New York Times reporter Gretchen Morgenson, "Countrywide has acknowledged that most of its modifications involved deferring overdue interest or adding the past due amount to a loan," not reducing interest rates or principal balances on subprime ARMs.*"*

I'd be remiss in not saying that there needs to be better scrutiny of lending practices and the rating agencies themselves. There is a consensus that the lack of effective oversight by the regulators of the primary and secondary mortgage markets contributed significantly to the problem we are now facing. Innovations in the mortgage industry can be good and useful. In fact, innovations by FHA, the secondary market and private sector lenders have been responsible for much of the unprecedented increase in the homeownership rate since World War II. At the same time, however, regulators can't be asleep at the switch and permit clearly unsound mortgage lending practices that place ordinary homebuyers at risk.

I applaud the White House and Treasury Secretary Paulson's continued efforts to encourage mortgage servicers to modify existing loans for a limited number of borrowers that cannot afford interest rate resets. However, depending solely upon the goodwill of an industry that bears no small measure of responsibility in this crisis is not the full answer.

I have been an advocate for free market principles and limited government for a long time so I know it's important for Congress to avoid an overreaction that would have negative long-term effects on the housing market. Allowing certain distressed homeowners limited bankruptcy protection provides the greatest potential benefit with the least market disruption, and it will not cost the Treasury a dime.

In closing, Mr. Chairman let me restate that the most pressing need is to help the more than 2.2 million families who are in danger of losing their homes. Of course, we need sound policies that prevent the kinds of abuses and disruptions we are now experiencing. But to help current homeowners we need measured and appropriate responses that have an immediate effect, to protect our citizens and encourage sound business practices.

As HUD Secretary, I saw firsthand that homeownership makes neighborhoods safer, encourages investment and raises our overall standard of living. People care more deeply about their neighborhoods if they have an ownership stake. Minorities, especially, need to be encouraged to own their homes in greater percentages if America is to truly democratize our free economic system. I hope the House will pass this legislation soon because I know how much America needs it. Thank you for the opportunity to testify here today and I look forward to your questions.

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i 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.