Testimony of Ellen Harnick, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Housing and Community Opportunity

"Examining the Making Home Affordable Program"

March 19, 2009

Good morning Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee. Thank you for inviting me to testify about the current state of home mortgage foreclosures and the Administration's "Making Home Affordable Program."

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. Self-Help's lending record includes a secondary market program that encourages other lenders to make sustainable loans to borrowers with credit blemishes. In total, Self-Help has provided over $5.6 billion of financing to 62,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

<u>Summary of Administration's program</u>

The Administration's Making Home Affordable Program represents a significant step forward, one that is essential and long overdue. It includes concrete and pragmatic measures to counter the perverse incentives that severed the interests of servicers from those of the borrowers and investors, and led servicers to pursue foreclosure even where the homeowner could afford a loan modification that would produce greater returns for investors as a whole. The program recognizes that, without government action, relying on servicers and investors to voluntarily modify troubled loans does not work.

In particular, Making Home Affordable does the following to re-align misplaced incentives, bring relief to struggling families, and get the housing market back on track:

- It sets a standard to establish the basic requirements of a sustainable loan modification for troubled mortgages. Among other things, the modification must be set so that the homeowner's first mortgage debt-to-income ratio (DTI) is no higher than 31% based on the homeowner's documented income. This goes a long way to making sure that the loan is affordable, thus protecting both the homeowner and the investor (and the taxpayer) by lowering the risk of re-default. It incents servicers and investors to meet this standard by sharing the cost with investors to move the borrower from a 38% DTI to a more affordable 31% ratio.

Servicers get a $1,000 up-front payment for each qualifying loan modification. An additional “pay for success” fee rewards homeowners for five years that the loan remains current and servicers for three years that the loan avoids default. Investors also get payments to compensate them for property value declines. These incentives will both encourage sustainable loan modifications and compensate servicers for the costs entailed.

- The program encourages lenders and servicers to work with at risk borrowers *before* they default, by providing bonus payments to both the investor and the servicer for modifying loans where default is imminent while the borrower is still current.

- The program also provides mechanisms for transparency and audits to ensure that modifications and refinances, another important part of the program, are implemented properly.

- Finally, the program calls on Congress to permit courts to implement an economically rational loan modification where the servicer or lender cannot or will not do so. The Bankruptcy Code has long empowered courts to perform this function for all manner of debt, including mortgages on commercial real estate, investor properties and vacation homes, but currently excludes the mortgage on the primary residence alone. We applaud the House of Representative for passing H.R.1106, the Helping Families Save Their Homes Act of 2009, to accomplish this objective. This legislation is an important component of the program and is necessary to any effort to meaningfully arrest the flood of foreclosures that have so impaired the housing and financial markets and the real economy.

Over two years ago, CRL forecast that 2.2 million families with subprime loans would lose their home to foreclosure.[1] Since that time, industry’s response has been consistently behind the curve.[2] We are approaching the second anniversary of the Homeownership Preservation Summit at which the nation’s largest lenders and loan servicers got together “to ensure that all that can be done on behalf of borrowers facing foreclosure is being done.”[3] However, only a tiny proportion of troubled homeowners were offered any form of modification at all, and the number of modifications that actually *reduced* the homeowner’s monthly payment was miniscule.

All the while, more and more families have fallen from the middle class into economic catastrophe. As we sit here today, every 13 seconds another home falls into foreclosure, to the tune of 6,600 new foreclosures every day, for a total of over 2 million new foreclosures this year alone, according to Credit Suisse projections.[4] It is now universally recognized that these foreclosures spread misery, far beyond the people immediately affected, to the economy as a whole, and that unless a substantial proportion of these foreclosures are prevented, our economic crisis will deepen and spread.

In this testimony I make the following points:

- <u>The Program is strong</u>. The Making Home Affordable Program is a comprehensive, well-thought-out and targeted plan with important tools for breaking through some of the main barriers precluding meaningful loan modifications on a scale sufficient to stabilize the housing sector of the economy.

- <u>Evaluation will be key</u>. The success of the program will ultimately depend upon investors' and loan servicers' willingness and capacity to participate and to modify qualifying loans with the diligence and speed that the times require. With foreclosures progressing at the rate of almost 200,000 each month, we do not have time to lose. Servicer and investor performance under the program must be closely monitored so that the program can be adjusted, or additional measures can be taken, if modifications do not occur at a rate appropriate to the scale and speed of the crisis. Take-up rates should be monitored to identify barriers to successful participation, such as the presence of second mortgages. Re-default rates should be similarly monitored to ensure that the program's prioritization of loan modification tools is effective. Unduly high redefaults could militate in favor of including principal write-downs as a required element of a qualifying modification.

- <u>Consumer protection compliance is important</u>. Treasury will need to carefully monitor lender and servicer compliance with the program's consumer protection rules and generally ensure that no abuses, such as requiring homeowners to waive existing rights, find their way into the process. Treasury should maintain an adequately staffed and well publicized hotline that consumers can use to report concerns.

- <u>Public loan-level reporting will be important</u>. Treasury should also require participating lenders and servicers to provide loan-level detail on the terms of the modifications they offer, both within the plan and outside it, as well as on outcomes for homeowners rejected for modification. This data should enable Treasury to measure servicer participation, evaluate success of modifications, identify areas for improvement, account for government obligations, provide a basis for informing state and local policymakers of mortgage-related trends in their jurisdiction, and ensure compliance with fair lending and other consumer protection laws. To build confidence in the program, Treasury should publicly disclose participation, modification, and success rates by servicer and also should make loan-level data available to independent researchers under common-sense protocols.

- <u>The program's plan to deal with second liens is crucial</u>. The program plans to address the ongoing problem posed by second mortgages. We look forward to the release of Treasury's schedule of the payments it will make to buy off second mortgages at a steep discount to their face value. While many of these mortgages are virtually worthless, it is necessary to offer second lien-holders some incentive to cooperate in the modification of the first mortgage.

- Judicial modification is an essential part of the Administration plan. We commend the House for passing H.R. 1106, the Helping Families Save Their Homes Act of 2009, and hope the Senate will quickly follow suit. By providing an alternative to foreclosure for homeowners whose servicers or lenders will not or cannot agree to economically rational modifications, the court-supervised loan modification provision will both provide an important last resort for homeowners with no other option, and increase the incentives for timely participation by servicers and lenders. The provision also would supplement the "servicer safe-harbor" provision of the bill by providing "cover" for servicers, as investors could not recover damages for a modification that recovers at least as much as a court would order in bankruptcy.

- The House should exempt principal forgiveness from taxation. We must not allow arbitrary tax rules to undermine the success of loan modifications. As it stands today, when a lender forgives part of a mortgage debt, some homeowners are required to pay taxes on the forgiven amount, while others are exempt. Specifically, mortgage debt forgiven on loans used for refinances, debt consolidation or relatively minor home repairs do not qualify for the exemption from taxes. This restriction is ironic, given that so much of the current foreclosure crisis was driving by refinancing and push-marketing that urged homeowners to take out mortgages for credit consolidation or home repairs. Loan modifications that come with a significant tax burden are likely to sabotage homeowners who are already struggling—meaning that all the time and expense invested in modifying the loan will be wasted. We therefore urge Congress to simplify the existing tax rules and to eliminate adverse tax consequence for all mortgage debt that is forgiven.

I. Background

A. Today's mortgage market.

While statistics seem almost unnecessary to illustrate what everyone here knows, every part of the mortgage origination system is in deep trouble. Overall mortgage activity has plummeted. For 2008, residential loan production cratered: $1.61 trillion compared to $2.65 trillion in 2007, and industry projections suggest that 2009 production will total just $1.09 trillion.[5]

Furthermore, originations of subprime, Alt A, and other non-prime mortgages all but stopped in 2008. Only an estimated $64.0 billion in such mortgages was originated last year, according to an analysis by Inside B&C Lending.[6] At its high point in 2006, nonprime lending constituted 33.6% of all mortgage production. By the fourth quarter of 2008, it had fallen to 2.8%.[7] These loans are not being originated in large part due to the collapse of the secondary market for these mortgages, which was driving the demand and facilitating the production, and analysts predict that 2009 will see "little or no non-agency securitization."[8] Tens of thousands of mortgage brokers have lost their jobs, and more are positioned to lose their jobs as lenders stop using independent brokers, mortgage insurers place additional restrictions on loans originated by brokers, and banks increase net worth requirements on third-party lenders.[9]

On the demand side as well, every major indicator is down. Between 2006 and 2008, existing home sales dropped 24 percent,[10] while new home sales and new construction starts plummeted by 54 and 58 percent, respectively.[11] In February, mortgage applications for the purchase of homes hit their lowest levels since April 1998.[12]

Our most recent report on subprime mortgages shows that over 1.5 million homes have already been lost to foreclosure, and another two million families with subprime loans are currently delinquent and in danger of losing their homes in the near future.[13] New projections of foreclosures on all types of mortgages during the next five years estimate 13 million defaults from 2008Q4 until 2014, across all segments of the market, from subprime to prime.[14] Right now, more than one in ten homeowners is facing mortgage trouble.[15] Nearly one in five homes is underwater.[16]

The flood of foreclosures we see today goes beyond the typical foreclosures of years past, which were precipitated by catastrophic and unforeseen events such as job loss, divorce, illness or death. The current crisis originated in losses triggered by the unsustainability of the mortgage itself, even without any changes in the families' situation, and even where the family qualified for, but was not offered, a loan that would have been sustainable.

The most common subprime loan marketed during the past four years is a highly risky loan called a hybrid adjustable-rate mortgage (ARM), often known as a 2/28 or 3/27 because the interest rate is fixed for either 2 or 3 years, and then the is adjustable, typically every six months, for the balance of the 30 year term. The three particularly tricky aspects of this loan are: first, that the rate jumps up, often sharply, at the end of the initial period, and often without regard to whether interest rates in the economy stay the same or even decline; second, lenders typically made these loans fully understanding that the borrower could not afford the rate increase, and would have to refinance before the rate reset; and third, refinancing before reset entails the payment of a steep "prepayment" penalty – typically equaling three to four percent of the loan balance.[17]

Sadly, many of the borrowers who are losing their homes to foreclosure qualified for better loans that they would be sustaining today. An investigation for the Wall Street Journal found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61%% "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[18] And even those borrowers who did not qualify for prime loans could have received sustainable, thirty-year fixed-rate loans, for at most half a percentage point to eight-tenth of a percentage point above the initial rate on the unsustainable exploding ARM loans they were given.[19] Had these borrowers received the sustainable loans they qualified for, we would not be facing the foreclosure crisis we are in today.

Unfortunately, the failure to protect borrowers from needlessly risky and unsustainable loans was followed by the failure to head off the crisis by implementing decisive measures to avert preventable foreclosures. We missed the opportunity to mitigate the crisis before its spillover effects reached neighboring homes, communities, and the housing and financial system itself. As a consequence, a crisis that started in the subprime market has now spread to the "Alt A" and prime markets as well.

The spillover costs of the foreclosure crisis are massive. Tens of millions of homes – households where, for the most part, the owners have paid their mortgages on time every month – are suffering a decrease in their property values that amounts to hundreds of billions of dollars in losses.[20] These losses, in turn, cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services. As property values decline further, the cycle of reduced demand and reduced mortgage origination continues to spiral downward.

B. A brief explanation of the recent meltdown.

A misalignment of incentives lies at the heart of today's mortgage meltdown.[21] Back in the days when families went to their local savings and loan to get a mortgage and the thrift held that loan among its own investments, the interests of borrowers and lenders were perfectly aligned: if the borrower did not pay the mortgage, the lender did not make money. But the proliferation of independent brokers and the growth of the secondary market upset that core alignment of interests between lender and borrower by creating a system where each actor was compensated early in the loan transaction, often within the first month of the loan term, thereby reducing or even eliminating the incentive to worry about how the borrower would fare later on.[22]

At the height of the housing bubble, independent mortgage brokers originated the vast majority of subprime loans, receiving their compensation from lenders immediately upon brokering the loan. Those lenders then sold the loan into the secondary market within weeks, where it was bundled together with other mortgages and sliced and diced into mortgage-backed securities (MBS). The facilitators of this process – the investment bankers, lawyers, and ratings agencies involved – were all paid their fees regardless of the performance of the MBS. Those securities were then sold to investors. At the same time, even more derivative products were layered on top of them, with credit default swaps at the top of the pyramid – what Warren Buffet identified as early as six years ago as "financial weapons of mass destruction."[23]

Stabilizing the housing sector requires effective measures to avoid unnecessary foreclosures – meaning those foreclosures resulting from the homeowner's inability to afford the current monthly loan payments, where the homeowner is willing and able to remain in the home if the loan is modified on an economically rational basis to make it affordable to the homeowner, and financially at least as beneficial to the investors as a foreclosure sale.

II. Current voluntary modification efforts have failed to stem the tide of foreclosures due to structural and legal barriers and distorted incentives.

A. The limits of voluntary modification efforts to date.

Despite the loss mitigation encouragement by HOPE NOW, the federal banking agencies, and state agencies, voluntary efforts undertaken thus far by lenders, servicers and investors have not yet been sufficient to stem the tide of foreclosures. Moreover, servicers still face significant obstacles in making modifications.

Seriously delinquent loans are at a record high for both subprime and prime loans.[24] All available data consistently indicate that continuing foreclosures far outpace total loss mitigation efforts and that only a small share of loss mitigation efforts result in true loan modifications that are likely to result in sustainable loans.

In October, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008.[25] Similarly, the most recent report from the State Foreclosure Prevention Working Group of Attorneys General and Banking Commissioners, which covers 13 servicers, 57% of the subprime market, and 4.6 million subprime loans, confirms that progress in stopping foreclosures is "profoundly disappointing."[26] Their data indicate that nearly eight out of ten seriously delinquent homeowners are not on track for any loss mitigation outcome, up from seven out of ten from their last report.[27] Even the homeowners who receive some kind of loss mitigation are increasingly losing their house through a short sale or deed-in-lieu rather than keeping the home through a loan modification or workout.[28]

What's more, when modifications and other workouts are made, they are frequently temporary or unsustainable, leading to re-default and placing homeowners and financial institutions in an even worse economic position than when they started. According to an analysis by Valparaiso Professor of Law Alan White, a national expert on foreclosure policy, of more than 3.5 million subprime and alt-A mortgages (all securitized), only 35% of modifications in the November 2008 report reduced monthly payments below the initial payment, while 20% left the payment the same and 45% increased the monthly payment.[29] Similarly, data through September 2008 indicate that the large majority of HOPE NOW efforts rely on repayment plans,[30] which typically require financially burdened households to add previously unpaid debt to their current mortgage payments.

In view of the foregoing, the recent report by the Office of the Comptroller of the Currency (OCC) regarding high loan modification redefault rates is unsurprising.[31] This report demonstrates is what we already suspected, which is that the modifications being made are not sustainable, affordable modifications. It is only common sense to predict that if a homeowner in default is given a higher rather than a lower monthly payment, there is a high probability of redefault.

In fact, other studies tracking the results obtained by different types of modifications show that certain types of modifications are much more successful than other types. According to a recent Lehman Brothers analysis, rate reduction modifications result in a more significant improvement in performance than principal and interest capitalizations that add past-due amounts onto the balance of the loan.[32] Credit Suisse reports that when interest rates or principal are reduced, the re-default rate is less than half of those for these other modifications.[33] In a January 13 paper, Goldman Sachs concluded, "Principal writedowns are always more effective in reducing default rates than note rate reductions."[34] And the OCC report suggests that modifications of mortgages held by a lender, rather than ones pooled into a mortgage-backed security, have been defaulting at lower rates, which further supports the notion that sustainable modifications can be made if obstacles to doing so can be overcome.[35]

B. Obstacles to modifications.

A recent Federal Reserve Staff Working Paper identifies a number of obstacles that limit the scale of modifications.[36] These obstacles help explain why voluntary loss mitigation has not kept up with demand.

- *Servicer Incentives:* The way servicers are compensated by lenders creates a market-distorting bias for moving forward with foreclosure rather than engaging in foreclosure prevention. Servicers are often not paid for modifications, but are reimbursed for foreclosure costs.[37] The Federal Reserve concludes, "Loan loss mitigation is labor intensive and thus raises servicing costs, which in turn make it more likely that a servicer would forego loss mitigation and pursue foreclosure even if the investor would be better off if foreclosure were avoided."[38]

- *Limited Servicer Staff and Technology:* With few but welcome recent exceptions, servicers have continued to process loan modifications through a labor-intensive, case-by-case review. While they have added staff and enhanced systems, the lack of transparent, standardized formulas has limited the number of modifications that have been produced.[39] Even when a servicer has a uniform methodology, the lack of transparency in the inputs to its net present value analysis, such as its selection of an appropriate discount rate, prevents borrowers and the public from properly evaluating modification decisions.

- *Second Liens:* Additional liens on a property pose a structural obstacle that is often impossible for servicers of the first lien to overcome. Between one-third and one-half of the homes purchased in 2006 with subprime mortgages have second mortgages,[40] and many more homeowners have open home equity lines of credit secured by their home. The holder of the first mortgage will not generally want to provide modifications that would simply free up homeowner resources to make payments on a formerly worthless junior lien, nor to modify a loan where there is a second mortgage in default. But as Credit Suisse reports, "it is often difficult, if not impossible, to force a second-lien holder to take the pain prior to a first-lien holder when it comes to modifications," thereby dooming the effort.[41]

- *Investor and PSA Concerns:* Servicers may shy away from modifications for fear of investor lawsuits.[42] While some Pooling and Servicing Agreements (PSAs)

> provide adequate authority to modify loans, these modifications may cause disproportionate harm to certain tranches of securities over other classes. Other PSAs include serious impediments to modifying securitized loans. For example, some limit the number or percentage of loans in a pool that can be modified.[43] Some impose modification costs on the servicers.

These obstacles must be addressed for any voluntary loan modification program to succeed.

III. The Making Home Affordable Program is a great improvement over earlier efforts to encourage loan modifications.

The Administration's program reflects the lessons learned from the failure of voluntary loan modification programs to meet the demands of the crisis to date. First, the program sets ground rules to specify what qualifies as an acceptable modification under the program. "Modifications" that just capitalize arrearages or increase monthly payments will not count.

Second, the program goes a long way toward addressing the obstacles posed by misaligned servicer incentives. The program will pay servicers $1,000 for each qualifying loan modification, plus an additional $1,000 per year for each year (up to three) that the modification is successfully sustained. And it will pay servicers an additional $500 for qualifying modifications made while the homeowner is at risk of default, but has not yet defaulted.[44] These payments should exceed the actual cost of the modification, turning Making Home Affordable modifications a profit center for the servicer. It is reasonable to hope that this will enable servicers to hire and train staff and invest in other infrastructure necessary to meet the demand.

So far, servicers have expressed support for the program, and the Chairman of the Mortgage Bankers Association, whose members include the major servicers, has expressed the view that servicers will participate.[45]

The program also provides for payments to investors of $1,500 per qualifying loan modification made before the at-risk homeowner has defaulted. This may prove helpful to servicers in addressing some investor concerns. The enactment of HR 1106 should go a long way toward addressing servicer concerns about lawsuits by investors. The bill's "safe harbor" provision shields servicers from liability for loan modifications for failing mortgages where the servicer reasonably believes that the principal recovery under the modification has a net present value that will exceed the principal to be recovered through foreclosure.[46] The bill's court-supervised loan modification provisions will render worthless any claim for damages against a servicer for a voluntary modification of a failing loan that yields more for investors than could be obtained in bankruptcy or foreclosure. We commend the House of Representatives for passing this bill, and its prompt enactment by the Senate is for these reasons important to ensuring the program's effectiveness.

Finally, while the details have yet to be made public, the program proposes to provide a schedule of payments for second-mortgage-holders to incent them to relinquish their claims. We look forward to Treasury's implementation of these second mortgage buyouts. The payments will be at a steep discount to face value, as these mortgages are frequently virtually worthless. But they are necessary to break through the barriers that the holders of these notes have imposed.

All of this depends, of course, on servicers' willingness to participate, and the promptness with which they modify loans under the program. This will have to be carefully monitored so that the program can be fine-tuned or supplemented by stronger measures as appropriate.

IV. Suggested steps to maximize the program's effectiveness.

A. Transparency.

Treasury should require participating lenders and servicers to provide loan-level detail on the terms of the modifications they offer, both within the program and modifications made by participating servicers outside the program. Participating servicers should be required to report on the outcomes for homeowners rejected for modification under the program. This data should enable Treasury to measure servicer participation, evaluate success of modifications, identify areas for improvement, account for government obligations, provide a basis for informing state and local policymakers of mortgage-related trends in their jurisdiction, and ensure compliance with fair lending and other consumer protection laws.

Transparency and openness with the public are essential. Treasury should publicly disclose participation, modification, and success rates by servicer and also should make loan-level data available to independent researchers under common-sense protocols.

B. Monitoring.

The success of the program will turn on: (1) the extent of servicer and lender participation; (2) the speed with which they modify loans under the program, (3) compliance with consumer protection standards – both by complying with limits expressly articulated in the program rules, and by not gaming the system to unfair advantage, such as by billing excessively large amounts for those fees that have not been prohibited – and complying with fair lending norms; and (4) the sustainability of modifications under the program.

Treasury will need to closely monitor the program with these four concerns in mind, and be prepared to intervene early to correct any problems that appear, or make adjustments to enhance effectiveness and fairness. Treasury and Congress should be prepared to act quickly to provide any additional mechanisms needed in the event that voluntary participation by servicers and lenders falls short of the substantial participation needed to stabilize the housing sector. They should be prepared also to take further measures to prioritize reductions in loan balances should other modification tools prove insufficient to generate modifications that are sustainable.

C. Tax Fix.

Finally, even the most carefully structured loan modifications can be seriously undermined if struggling homeowners must treat the forgiven mortgage debt as taxable income. Congress has already recognized this problem, and partially addressed the issue by passing the Mortgage Forgiveness Debt Relief Act of 2007, which was intended to prevent adverse tax consequences for homeowners.

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

The fact is, a large majority of homeowners in trouble have at least some "unqualified" debt, because so much of the current foreclosure crisis was driven by refinancing rather than initial home purchase and because predatory mortgages were push-marketed to people encouraging them to use the new loan for home repair or credit consolidation. More than half of all subprime mortgages were refinances.

What's more, expanding the definition will make it easier for everyone, even those homeowners already fully covered by the Mortgage Forgiveness Debt Relief Act, to take advantage of this exclusion. To take advantage of the mortgage debt exclusion, a homeowner now has to file a long-form 1040, along with a Form 982, a very complicated and difficult form. Unfortunately, most lower and middle income taxpayers are not accustomed to using these forms, and taxpayers filing long-form 1040s are not eligible to use the various tax clinics offered by the IRS and others for lower-income taxpayers.[47] If the definition of qualified mortgage debt is expanded as described above, the IRS can take steps through its tax forms to simplify the process for taxpayers claiming the mortgage debt exclusion.

Because one in six homeowners with mortgages is underwater, it is clear that the tax consequences of forgiveness in the context of short sales and principal write-downs from modifications will become an increasingly significant problem.[48] Significantly, solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[49]

Conclusion

There is no single solution to the challenges facing us today, but the Making Home Affordable Program is a significant step forward that has the potential to meaningfully mitigate the foreclosure crisis. Careful monitoring will be necessary so that any needed changes to the program can be identified and implemented promptly so that the crisis does not deepen. We hope the Senate will quickly pass the Helping Families Save Their Homes Act of 2009 to amend the Bankruptcy Code to enable judges to accomplish economically rational and sustainable modifications as called for by the program, and implement a "safe harbor" for services. We also urge Congress to fix the gap in the Internal Revenue Code that can undermine the most effective loan modification tool available.

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[1] Ellen Schloemer, Wei Li, Keith Ernst & Kathleen Keest, "Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners," Center for Responsible Lending (Dec. 2006), available at, http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf.

[2] For example, as late as 2007, the Mortgage Bankers Association continued to assert that subprime foreclosures would not damage the broader economy. In May 2007, the Association's then-Chairman John Robbins asserted: "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy." (Statement of John M. Robbins, CMB, Chairman, Mortgage Bankers Association at the National Press Club's Newsmakers Lunch, Washington, DC (May 22, 2007)).

[3] John M. Robbins, Chairman, Mortgage Bankers Association, Homeownership Preservation Summit, *available at* http://dodd.senate.gov/index.php?q=node/3870.

[4] Credit Suisse Fixed Income Research, "Foreclosure Update: Over 8 million Foreclosures Expected," (Dec. 4, 2008) at 3, *available at* www.credit-suisse.com/researchanalytics.

[5] *National Mortgage News* (March 9, 2009).

[6] *Inside B&C Lending* (February 27, 2009).

[7] Id.

[8] *Inside Mortgage Finance MBS Database.*

[9] *National Mortgage News* (March 9, 2009).

[10] National Association of Realtors, http://www.realtor.org/research/research/ehsdata.

[11] US Census Bureau, http://www.census.gov/const/quarterly_sales.pdf and http://www.census.gov/const/www/quarterly_starts_completions.pdf.

[12] Based on the Mortgage Bankers Association's Weekly Mortgage Applications Survey for the week ending February 27, 2009. The four-week moving average for the seasonally adjusted Purchase Index reached its lowest level since April 1998. *See* www.mortgagebankers.org/NewsandMedia/PressCenter/67976.htm.

[13] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today*, p.2 (Jan. 8, 2009) [hereinafter "*Continued Decay*"], *available at*

http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html.

[14] Goldman Sachs Global ECS Research, Home Prices and Credit Losses: Projections and Policy Options (Jan. 13, 2009), p. 16; *see also* Credit Suisse Fixed Income Research, Foreclosure Update: Over 8 Million Foreclosures Expected, p.1 (Dec. 4, 2008).

[15] Mortgage Bankers Association National Delinquency Study (March 5, 2009).

[16] First American Core Logic (March 4, 2009).

17 Additionally, subprime lenders generally did not escrow for taxes and insurance as prime lenders do, which left many families reeling when those bills came due. This practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs. A study by the Home Ownership Preservation Initiative in Chicago found that for as many as one in seven low-income borrowers facing difficulty in managing their mortgage payments, the lack of escrow of tax and insurance payments were a contributing factor. Partnership Lessons and Results: Three Year Final Report, p. 31 Home Ownership Preservation Initiative, (July 17, 2006) at www.nhschicago.org/downloads/82HOPI3YearReport_Jul17-06.pdf.

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

19 January 25, 2007 letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3.

20 Continued Decay, p. 3.

[21] For a much longer discussion of the roots of today's crisis, see Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf [hereinafter "Stein Testimony October 2008].

[22] Chairman Bernanke makes this point in a recent presentation: "Housing, Housing Finance, and Monetary Policy," remarks by Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System at the Federal Reserve Bank of Kansas City's Economic Symposium – Jackson, Hole, Wyoming (August 31, 2007), pp. 16 – 17.

[23] Berkshire Hathaway Annual Report (2002).

[24] *See* HOPE NOW Data for all periods, *available at* http://www.hopenow.com/upload/data/files/July%202008%20Industry%20Extrapolations.pdf.

[25] Credit Suisse Fixed Income Research, *Subprime Loan Modifications Update*, October 1, 2008, p.2, *available at* http://www.credit-suisse.com/researchandanalytics [hereinafter "Credit Suisse Update"].

[26] State Foreclosure Prevention Working Group, *Analysis of Subprime Servicing Performance*, Sept. 2008, at 2, *available at* http://www.mass.gov/Cago/docs/press/2008_09_29_foreclosure_report_attachment1.pdf.

[27] Id. at 6.

[28] Id. at 7-9.

[29] Alan White, *Deleveraging American Homeowners: December 18, 2008 Update to August 2008 Report*, Valparaiso University School of Law (December 2008), p.2.

[30] *HOPE NOW Loss Mitigation National Data July 07 to September 08*, p.9 HOPE NOW Alliance (October 2008) *available at* http://www.hopenow.com/upload/data/files/HOPE%20NOW%20Loss%20Mitigation%20National%20Data%20July%2007%20to%20September%2008.pdf.

[31] *See* OCC and OTS Mortgage Metrics Report (Third Quarter 2008), *available at* http://occ.gov/ftp/release/2008-150a.pdf [hereinafter "OCC Report"]. One of the many concerns about this report is that meaningful, sustainable loan modification efforts did not become active until the third and fourth quarters of 2008, long after the OCC's data was collected, including the streamlined modification programs being used by the FDIC for IndyMac Federal Bank and by Fannie Mae and Freddie Mac.

[32] Lehman Bros. U.S. Securitized Products Fixed Income Research, *The Loan Modification Story So Far* (Sept. 11, 2008), p. 2.

[33] Credit Suisse Update, p.1.

[34] *Home Prices and Credit Losses*, p. 19.

[35] OCC Report, pp. 5-6. We hope that the OCC will release disaggregated data, which we anticipate would show that when modifications reduce monthly payments and are made in accordance with the homeowner's ability to pay, these modifications are much less likely to redefault than modifications that do not reduce or even raise monthly payments.

[36] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, *The Incentives of Mortgage Servicers: Myths and Realities*, (Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46) [hereinafter *Myths and Realities*].

[37] *See* Testimony of Stein Testimony October 2008 at fn 30.

[38] *Myths and Realities*, p 15.

[39] Id. at 3, 9, 23.

[40] Credit Suisse, *Mortgage Liquidity du Jour: Underestimated No More*, March 12, 2007 at 5.

[41] Credit Suisse Update, p. 8.

[42] *See* Bajaj, Vikas and Meier, Barry, *Some Hedge Funds Argue Against Proposals to Modify Mortgages*, New York Times, October 23, 2008.

[43] *See* Credit Suisse, *The Day After Tomorrow: Payment Shock and Loan Modifications*, Apr. 5, 2007 (noting specific examples of PSAs with various modification restrictions, including 5% by balance, 5% by loan count, limits on frequency, and limits on interest rate).

[44] The refinance portion of the program also reflects the Administration's recognition that it is important to help borrowers take advantage of historically low interest rates who would otherwise be shut out of the refinance market due to property price declines. Thus, the program's refinance provisions permit borrowers whose loans are held or guaranteed by Fannie Mae and Freddie Mac, who have current loan to values over 80% and less than 105%, to refinance. This will help qualifying borrowers to stabilize their finances, reduce the possibility that they will default in the future, and stimulate the economy b/c of hundreds of dollars of savings per year. We believe that the Administration should investigate the possibility of increasing the eligible loan to value to 125% to help borrowers more severely underwater,

and therefore more at risk of default, although we recognize that there are issues related to securitization to be considered and worked out.

[45] See statements of Mortgage Bankers Association President and CEO John Courson, NewsHour with Jim Lehrer, "Public, Bankers, Analysts Debate Merits of Obama's Foreclosure," (Feb. 19, 2009), *available at* http://www.pbs.org/newshour/bb/business/jan-june09/foreclosures_02-19.html

[46] Helping Families Save Their Homes Act of 2009, sec. 201.

[47] Apparently comparatively few Form 982s were filed for the 2007 tax year, which suggests that there is already widespread failure either to take advantage of the exception or to pay the COD tax owed.

[48] See Zillow, http://zillow.mediaroom.com/index.php?s=159&item=103; see also First American Core Logic http://www.housingwire.com/2008/10/31/76-million-borrowers-underwater-on-mortgages-study/

[49] National Taxpayer Advocate, 2008 Annual Report to Congress, p. 341, 391-396.