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

"The Housing Crisis in Los Angeles and Responses to Preventing Foreclosures and Foreclosure Rescue Fraud"

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Good morning Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee. Thank you for inviting me to testify about the housing crisis and foreclosure prevention efforts.

I serve as 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.

Over two years ago, CRL forecasted that 2.2 million families with subprime loans would lose their homes 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 small proportion of troubled homeowners have been offered any form of modification at all, and the number of modifications that have *reduced* the homeowner's monthly payment has been even smaller.

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 neighbors, cities, and the economy as a whole –, and that unless a substantial proportion of these foreclosures are prevented, our economic crisis will deepen and spread.

I. The Fallout From The Foreclosure Crisis: Foreclosures and Families at Risk

CRL's most recent report on subprime mortgages shows that over 1.5 million homes have already been lost to foreclosure nationwide, and another two million families with subprime loans are currently delinquent and in danger of losing their homes in the near future.[5] Goldman

Sachs estimates that there will be 13 million defaults between 2008Q4 until 2014, across all segments of the market, from subprime to prime.[6]

The figures in California are particularly alarming. More than 235,000 California homes were lost to foreclosure in 2008, nearly tripling the previous annual record of 85,000 from a year earlier.[7] In Los Angeles County alone, more than 70,000 homeowners received Notices of Default (the first step in foreclosure), and more than 40,000 families lost their homes in 2008.[8]

CRL projects that, absent strong action, more than 460,000 Californians will lose their homes to foreclosure in 2009, and more than 1.5 million California families will lose their homes over the next four years. For the 35th Congressional District, CRL projects that one in five subprime loans – including 3,974 loans made in 2005 and 2006 alone – will end in foreclosure.

Right now, more than one in ten homeowners is facing mortgage trouble.[9] Nearly one in five mortgages nationwide is underwater.[10] California, having seen some of the most extreme housing appreciation during the boom, is now bearing the brunt of the bursting bubble. When mortgages have such high loan to value ratios and/or negative amortization features, it doesn't take a significant drop in the housing market to cause problems. Currently, there are an estimated 1.9 million borrowers in California who are under water on their mortgages, 300,000 of which are in the Los Angeles area,[11] and 723,000 California borrowers are facing "severe" negative equity (owing 125% or more of the home value), which accounts for nearly one-third of all "severe" negative equity borrowers nationwide.[12]

As if this were not enough, another large wave of foreclosures in the Alt-A market is on the horizon, and California will again be hit hard, given its large market share of these loans. There are more than 650,000 Alt-A loans in California, including nearly 200,000 Option ARMs.[13] Most of these loans will recast in 2009-2012, requiring large payment increases and potential defaults.[14] Option ARMs – of which California has 55-60% of the national total – permit negative amortization of the loan, a feature that causes loans to be even further under water than they otherwise would have been from the housing price decline.

The foreclosure crisis originated in home losses triggered by the unsustainability of the mortgages themselves, even without any changes in the families' situation. Unfortunately, the failure to protect borrowers from needlessly risky and unsustainable loans was followed by the failure to head off the crisis with decisive measures to avert preventable foreclosures. We missed the opportunity to mitigate the crisis before its spillover effects reached neighboring homes, communities, the housing and financial system itself, and the broader economy. As a consequence, a crisis that started in the subprime market has now spread to the "Alt A" and prime markets as well.

Because the decline in home prices and the economic recession brought on by the abusive and dangerous loans, typical foreclosures of years past – income interruptions caused by job loss, divorce, illness or death – have become more powerful than ever. As unemployment worsens, we will see more defaults, and then more foreclosures, as borrowers' options for keeping their homes – without steady income – fade away. California's unemployment rate is more than one-

third higher than the U.S. total – 10.9% statewide versus 8.1% nationally.[15] Los Angeles County is slightly higher even with 11% unemployment.[16]
The spillover costs of the foreclosure crisis are massive. Tens of millions of homes – households where the owners generally 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.[17] In the 35th Congressional District, CRL projects that foreclosures will have a spillover effect on more than 215,000 surrounding homes, for a decrease of $3.38 billion in home equity. 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.

II. A Brief Explanation Of The Meltdown.

Buying or refinancing a home is the biggest investment that most families ever make. For the vast majority of Americans, this transaction is often decisive in determining a family's future financial security. For this reason alone, prospective homeowners cannot be treated with a hands-off, caveat-emptor approach. But recent events have shown us the macroeconomic importance of affordable mortgages for homeowners. Rules of the road for mortgage lending are not just for the benefit of individual families, but for the benefit of the entire housing market and national economy.

A. Dangerous Lending Greatly Inflated The Housing Bubble, And The Resulting Foreclosures Are Magnifying The Damage Of The Bubble's Collapse.

A misalignment of incentives lies at the heart of today's mortgage meltdown.[18] 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 any interest in how the borrower would fare with that loan down the road.[19]

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) that received AAA ratings from the rating agencies. During the current decade, the volume of subprime and Alt-A lending expanded tremendously as Wall Street securitized these loans and made virtually unlimited capital available to subprime lenders, with the riskiest loans providing the greatest returns. 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 – what Warren Buffet identified

as early as six years ago as "financial weapons of mass destruction."[20] – at the top of the pyramid.

This reckless lending spurred historically high home price inflation. The housing bubble expanded dangerously high in states such as California, Nevada and Florida. The massive inflation in home prices temporarily masked the long-term unsustainability of these mortgages, as homeowners whose loans reset to much higher rates were able to refinance those loans by borrowing against the new "equity" in their home. When borrowers expressed concerns about future payment increases, lenders routinely told them not to worry about it, since they could always refinance. Indeed, the seemingly continuous appreciation spurred a constant market for aggressive mortgage refinancing, further swelling the bubble.

The rest of the story is well known. The bursting of a housing bubble is always a painful economic event, but the effects of today's falling prices are severely exacerbated by millions of needlessly dangerous mortgages that have failed or are poised to fail. When homeowners could no longer refinance, these unsustainable mortgages turned into the massive foreclosures we are continuing to see today.

B. <u>This Lending Binge Was Abetted By Regulators Who Ignored The Risks</u>.

The great experiment in subprime and Alt-A securitization took place largely unhindered by any meaningful rules. Imagine a scenario where the most dangerous intersections have no traffic signals. When the police are asked to intervene, they decline, saying they don't want to stop the free flow of traffic. Meanwhile, the collisions keep piling up until the wreckage is a problem for everyone.

When advocates or lawmakers suggested strengthening oversight on the sector providing the riskiest home loans, the inevitable response was, "We don't want to stop the free flow of credit." Unfortunately, the ideology that lending should not be restrained at any cost infected most agencies, particularly the Federal Reserve under Chairman Greenspan,[21] who had the power to issue rules outlawing unfair and deceptive mortgages across the country, and the Office of Thrift Supervision. Today it is abundantly clear that the *lack* of common-sense rules—which should have been applied by agencies with specific duties to ensure safety and soundness in the market and protect families—has impeded the flow of credit beyond anyone's wildest imagination.

III. <u>Voluntary Modification Efforts To Date Have Failed To Stem The Tide Of Foreclosures Due To Structural And Legal Barriers And Distorted Incentives.</u>

A. <u>The Limits Of Voluntary Modification Efforts To Date.</u>

Despite 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. 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. Moreover, servicers still face significant obstacles in making modifications. As a result, seriously delinquent loans are at a record high for both subprime and prime loans.[22]

In October, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008.[23] 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, confirmed that progress in stopping foreclosures has been "profoundly disappointing."[24] 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.[25] 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.[26]

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 borrower's monthly payment*.[27] HOPE NOW data is equally telling – a full 65% of workouts through January 2009 were repayment plans, and while the percentage of modifications has been increasing, data from 4Q 2008 continues to demonstrate that the majority of the HOPE NOW efforts rely on repayment plans,[28] which typically increase monthly payments by requiring financially burdened households to add previously unpaid debt to their current mortgage payments. The same story plays out in California as well, with HOPE NOW data indicating that foreclosure starts and foreclosure sales dwarf the number of workout plans, and repayment plans exceed slightly the number of loan modifications in the 3Q of 2008.[29]

Studies that track 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.[30] 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.[31] In a January 13 paper, Goldman Sachs concluded, "Principal writedowns are always more effective in reducing default rates than note rate reductions."[32] Finally, a recent 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.[33]

B. Obstacles to Modifications.

A recent Federal Reserve Staff Working Paper identifies a number of obstacles that limit the scale of modifications.[34] 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.[35] 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."[36]

- *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.[37] 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,[38] 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.[39]

- *Investor and PSA Concerns:* Servicers may shy away from modifications for fear of investor lawsuits.[40] 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.[41] Some impose modification costs on the servicers.

C. The Making Home Affordable Program Is A Great Improvement Over Earlier Efforts To Encourage Loan Modifications And Addresses Many Of The Existing Obstacles

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 have disconnected the interests of servicers from those of the borrowers and investors, and have 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 overcome the obstacles that have hampered significant loan modification efforts to date:

- *Servicer & Investor Incentives.* The program sets a standard to establish the basic requirements of a sustainable loan modification for troubled mortgages. The program aims to modify mortages 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 ratio goes a long way to making sure that the loan is affordable, threby protecting both the homeowner and the investor (and the taxpayer) by lowering the risk of redefault. It incents servicers and investors to meet this standard by sharing the cost with investors: once the servicer gets the borrower to a 38% DTI, the government will provide an additional subsidy to help get to the 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.

- *Pre-Default Modification Incentives.* The program encourages lenders and servicers to work with at risk borrowers *before* they default, by providing $500 to servicers and $1,500 to investors for qualifying modifications made while the homeowner is at risk of default, but has not yet defaulted.[42]

- *Addressing Risks of Investor Lawsuits.* The program calls on Congress to provide a "safe harbor" to shield 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.[43] H.R. 1106, passed by the House of Representatives, includes this provision, although it has not yet been passed by the Senate. Additionally, by providing industry standards for loan modifications, including affordability and net present value calculations, the program reduces the type of uncertainty that can bring about litigation risk.

- *Second Liens.* The administration has indicated its intent to deal with second liens. This plan will be crucial. 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 Modifications As Stick to Encourage For Servicer & Investor Modifications And Last Resort for Borrower.* Finally, the program calls on Congress to permit bankruptcy 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 almost every type of debt, including mortgages on commercial real estate, investor properties and vacation homes, but currently excludes the mortgage on the primary residence alone. This provision also has passed the House of

Representative in H.R.1106, but has not yet passed the Senate. 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.

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.[44]

IV. Suggested Steps To Maximize The Program's Effectiveness.

Although the Administration's foreclosure-prevention program provides great promise, there are various measures that should be taken and various laws that should be passed 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.

Moreover, with a public increasingly demanding transparency and openness, 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 and fair lending 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 (4) the sustainability of modifications under the program.

Treasury will need to 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. If the existing modification tools prove insufficient to generate modifications that are sustainable, they should be prepared to go a step further by focusing on reductions of principal.

C. Tax Fix.

The House should exempt any borrowers' loan forgiveness from taxation. We must not allow arbitrary tax rules to undermine the success of loan modifications. Under existing law, 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 to refinance, for debt consolidation or for 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, and will result in a waste of the time and expense invested in modifying the loan. We therefore urge Congress to simplify the existing tax rules and to eliminate adverse tax consequence for all mortgage debt that is forgiven.

Because one in five 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.[45] Significantly, solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[46]

D. Public Loan-Level Reporting Will Be Important To Ensure Compliance And Provide Transparency And Accountability.

Treasury should 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, fair housing, 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.

V. Judicial Modification Is An Essential Part Of The Administration's Foreclosures Prevention Plan.

Lifting the ban on judicial loan modifications for primary residences is an essential component of the Obama plan. Judicial modification of loans is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century or investment banks like Lehman Bros., but is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in chapter 13 payment plans.

This provision will provide a new avenue for reducing hundreds of thousands of foreclosures *without requiring any tax dollars*. Equally important, it will provide stronger incentives for loan servicers to offer effective loan modifications outside of court. Giving homeowners access to the courts means that voluntary private efforts to prevent foreclosures will work better. Moreover, paired with the comprehensive and well-thought-out modification plan, many fewer families will need to resort to bankruptcy.

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 lenders, servicers and/or investors. 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.

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 Treasury to require detailed reporting to provide needed transparency and accountability that has been lacking.

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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" at 3 (Dec. 4, 2008), available at www.credit-suisse.com/researchanalytics.

[5] Center for Responsible Lending, "Continued Decay and Shaky Repairs: The State of Subprime Loans Today" at 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.

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

[7] The total number of recorded Trustee Deeds for 2007 in California was 84,375, and the total number for 2008 was 235,976, based on combining the quarterly reports. *See generally* www.dqnews.com.

[8] The total number of Notices of Default filed in Los Angeles County was 73,454, and the total number of recorded Trustee Deeds for 2008 in California 2Q – 4Q was 38,043; unfortunately the 1Q number was not available. *See generally* www.dqnews.com (based on combining the quarterly reports).

[9] Mortgage Bankers Association National Delinquency Study (Mar. 5, 2009).

[10] First American Core Logic (Mar. 4, 2009).

[11] E. Scott Reckard & Peter Hong, "Obama Plan To Prevent Foreclosures Won't Help Many California Homeowners," *Los Angeles Times* (Mar. 6, 2009) (citing First American Core Logic), available at http://articles.latimes.com/2009/mar/06/business/fi-housing6?s=g&n=n&m=Broad&rd=www.google.com&tnid=1&sessid=89cf52053ae4eac3a39ebf9eae5db9b1f52e52d1&uuid=89cf52053ae4eac3a39ebf9eae5db9b1f52e52d1&pg=0&pgtp=article&eagi=&cat=finance+%26+insurance&page_type=article&exci=2009_03_06_business_fi-housing6

[12] *Id.*

[13] California has about 55-60% of all Option ARMs nationwide. CRL calculations, based on First American Core Logic, LoanPerformance Data provided by NY Fed (June 2008), available at www.newyorkfed.org/mortgagemaps/.

[14] Vikas Bajaj, "Housing Lenders Fear Bigger Wave of Loan Defaults," *New York Times* (Aug. 4, 2008), available at http://www.nytimes.com/2008/08/04/business/04lend.html?_r=1&scp=3&sq=option%20arm&st=cse&oref=slogin; Prashant Gopal, "The Next Real Estate Crisis," *Business Week* (June 5, 2008), available at http://www.businessweek.com/lifestyle/content/jun2008/bw2008065_526168.htm; Fitch Ratings, "Option ARMs: It's Later Than It Seems" (Sept. 2, 2008). Some data indicates that only 17% of Option ARMs originated between 2004 and 2007 were fully documented.[14] Given the prevalence of these products in the extreme bubble regions (California, Florida, Nevada), the almost complete failure to verify ability to pay strongly suggests that the 2004-07 vintages were, at best, "asset-based underwriting" – assuming repayment capacity would come from appreciation – or, more likely, were simply originated to generate more originations while the euphoria lasted. "Option ARMs: It's Later Than It Seems" at 5.

[15] "Unemployment in California: The Decline and Fall of the California Job Market" (Interactive Map), *Sacramento Bee* (Mar. 19, 2009), available at http://www.sacbee.com/1232/rich_media/1698037.html; Bureau of Labor Statistics, "The Employment Situation: February 2009" (Mar. 6, 2009), available at http://www.bls.gov/news.release/empsit.nr0.htm.

[16] "Unemployment in California: The Decline and Fall of the California Job Market" (Interactive Map), *Sacramento Bee* (Mar. 19, 2009).

17 "Continued Decay" at 3.

[18] 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"].

[19] Chairman Bernanke makes this point in a recent presentation: "Housing, Housing Finance, and Monetary Policy" at 16 – 17, 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),

[20] Berkshire Hathaway Annual Report (2002).

[21] Alan Greenspan recently admitted, in testimony before the House Committee on Oversight and Government Reform, that he was mistaken to have relied upon the free market to regulate itself: "Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief." Edmund L. Andrews, "Greenspan Admits Error on Regulation," *New York Times* (Oct. 23, 2008), available at http://www.nytimes.com/2008/10/24/business/economy/24panel.html.

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

[23] Credit Suisse Fixed Income Research, "Subprime Loan Modifications Update" at 2 (Oct. 1, 2008), available at http://www.credit-suisse.com/researchandanalytics [hereinafter "Credit Suisse Update"].

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

[25] *Id.* at 6.

[26] *Id.* at 7-9.

[27] Alan White, "Deleveraging American Homeowners: December 18, 2008 Update to August 2008 Report" at 2 Valparaiso University School of Law (Dec. 2008).

[28] HOPE NOW Alliance, "HOPE NOW Loss Mitigation Data July 07 to January 09," available at http://www.hopenow.com/upload/data/files/HOPE%20NOW%20National%20Data%20July07%20to%20January09.pdf (showing that 52% of 4Q 2008 workouts were repayment plans).

[29] Hope Now Alliance Servicing Data, 3rd Quarter 2008.

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

[31] "Credit Suisse Update" at 1.

[32] "Home Prices and Credit Losses" at 19.

[33] *See* OCC and OTS Mortgage Metrics Report at 5-6 (Third Quarter 2008), *available at* http://occ.gov/ftp/release/2008-150a.pdf [hereinafter "OCC Report"]. 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.

[34] 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"].

[35] *See* "Stein Testimony October 2008" at n. 30.

[36] "Myths and Realities" at 15.

[37] *Id.* at 3, 9, 23.

[38] Credit Suisse, "Mortgage Liquidity du Jour: Underestimated No More" at 5 (Mar. 12, 2007).

[39] "Credit Suisse Update" at 8.

[40] *See* Bajaj, Vikas and Meier, Barry, "Some Hedge Funds Argue Against Proposals to Modify Mortgages," *New York Times* (Oct. 23, 2008).

[41] *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).

[42] 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.

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

[44] *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

[45] *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/

[46] National Taxpayer Advocate, 2008 Annual Report to Congress at 341, 391-96.