

Mandatory Foreclosure Moratorium Has Severe Implications for Borrowers and Industry

MBA RECOMMENDS

Legislatures should not enact a foreclosure moratorium or mandatory payment forbearance, as moratoriums and forbearances will increase the number of delinquencies, harm the borrower's ability to recover and are likely to fail to save homes from foreclosure sale.

BACKGROUND

During 2003 through 2006, home prices increased at a pace that far exceeded inflation. During that time, many mortgages were written with adjustable interest rates and/or negative amortization features to allow borrowers to purchase homes. In 2007, this rapid appreciation slowed and even began to reverse in some locations, resulting in record borrower defaults and foreclosures. While foreclosure is an undesirable outcome for borrowers and lenders, the concept of a broad foreclosure moratorium or mandatory forbearance policy is not good public policy. Because few moratorium proposals are accompanied with solutions to be implemented during the moratorium, it is unclear how such proposals will materially save homes from foreclosure. MBA is very concerned that such a proposal would only add cost to the process for borrowers and loan servicers by preventing or delaying servicers from taking important statutorily required steps, such as sending breach letters, accelerating the debt, or initiating foreclosure.

AVOID ENACTING MANDATORY MORATORIUM

In designing a comprehensive economic stimulus plan, a foreclosure moratorium should not be enacted. MBA urges legislatures to consider the following evidence of why this would be bad public policy:

- It is unclear that a moratorium will increase the number of homes saved from foreclosure sale. Historically there is very little success with saving homes where the property has been abandoned, converted to rental property but is no longer profitable, damaged or subject to code violations, or where the borrower does not have the means to support the loan at any level, has sufficient income to pay the loan but decides to stop paying because the property has declined in value, or simply does not wish to stay in the home. Delaying the inevitable foreclosure only adds costs for borrowers and lenders in these cases and increases the chance of property deterioration.
- Imposing a moratorium on foreclosure will increase the number of delinquencies as borrowers who would otherwise stretch to continue to make payments will decide to stop at least for the duration of the moratorium. The cost to the servicing industry to continue to advance principal, interest, tax and insurance payments during this period of forbearance could cause severe financial hardships for individual companies, which most likely do not own the loans, but merely administer them. The hardship imposed on servicers would be widespread, but would not have any correlation to any wrong-doing. MBA would view such a government action as an unfunded and unfair mandate.

- A foreclosure moratorium will unintentionally harm the borrower's ability to recover. Statistically, the longer the borrower remains delinquent, the less likely he or she will be able to become current again. A mandatory foreclosure moratorium gives no discretion to lenders to determine when forbearance is appropriate. Creating incentives for borrowers to remain or become delinquent can decrease their chances of recovery.
- Any mandated moratorium, by its very nature, will increase the number of severe delinquencies (90 or more days delinquent). Under risk-based capital rules, loans that are 90 days or more past due are subject to a 100 percent risk weighting (as compared to loans that are current or below 90 days delinquent, which carry a 50 percent risk weighting). A broad application of a forbearance period could affect financial institutions' capital requirements and rankings.
- There is significant time already built into the delinquency and foreclosure process for borrowers to work out a solution with servicers. Cases are generally not referred to a foreclosure attorney until the loan is 90-120 days past due. The foreclosure attorney must prepare the petition for foreclosure and file it with the appropriate court or begin the statutorily prescribed notices that pre-condition non-judicial foreclosure. Service of process and hearings follow. This is not a quick process. In New York, for example, it takes approximately 13 months from the petition filing date to reach foreclosure sale (ie., an average of 19 months from due date of last paid installment to foreclosure sale). In Pennsylvania, it takes approximately 10 months. Foreclosure timelines are shorter in non-judicial states and those processes have been developed and vetted by the state legislatures over many decades. It is important to stress that servicers continue to work with borrowers even when the loan is "in foreclosure." Diligent borrowers can avoid the initiation of foreclosure and foreclosure sale by seeking help from the servicer.



Congress Should Avoid Further Destabilization of the Mortgage Lending Market through Bankruptcy Cram Down

MBA RECOMMENDS

Congress should defeat bankruptcy reform legislation that would allow cram downs of mortgages secured by primary residences in order to avoid further dislocations in the mortgage lending market. Permitting cram down will adversely impact mortgage interest rates and credit availability because lenders will be faced with new levels of uncertainty as to loss. As a result, borrowers would face higher downpayments, higher costs at closing, higher interest rates and could lose access to government loan programs.

BACKGROUND: THE REAL IMPACT OF CRAM DOWN

As the mortgage and capital markets continue to experience instability and re-adjust following a once-in-a-generation upheaval, government should avoid policies that will worsen the situation and make it more difficult for the market to recover. One of the most harmful legislative proposals, known as cram down legislation, would allow bankruptcy judges to change the terms of a mortgage, even writing down the amount owed. If this were to happen, the mortgage market will have no choice but to respond by pricing this new risk into the cost of mortgages through higher rates, fees and downpayments on all consumers. Cram down legislation will also make it far more difficult to sell mortgages in the secondary market, will reduce liquidity, and ultimately is not the most effective way to help borrowers.

CRAM DOWN LEGISLATION WOULD HURT THE FHA AND VA

Principal cram down renders ineffective certain portions of government mortgage insurance (such as Federal Housing Administration (FHA) insurance and Veterans Affairs (VA) guarantees) and private mortgage insurance that currently protect servicers and investors against principal losses.

FHA and VA indicate they do not have statutory authority to pay the servicer a claim for amounts crammed down in bankruptcy. FHA, VA and private mortgage insurance protects lienholders from principal loss in the event of foreclosure, but the protections will be lost on the amount crammed down. Fannie Mae and Freddie Mac, therefore, will also suffer greater losses. As a result, servicers and investors will be taking on significant additional credit risk on new and existing loans and will price for that risk. That price will be passed on to consumers.

CRAM DOWN LEGISLATION EXTINGUISHES LENDERS' INTERESTS IN HAZARD INSURANCE CLAIMS

Cram down makes it harder for lenders to recover their interests in cases where hazard insurance comes into play. If a property is damaged, by flood or fire, for example, and the loan amount is crammed down to the fair market value of the damaged property, the lender would not be able to receive the insurance in the amount crammed down. Because property values decline when damaged by a natural disaster, cram downs could eliminate all or a substantial part of the debt and also eliminate the lender's ability to recover through hazard insurance claims.

CRAM DOWN LEGISLATION TREATS HOME LOANS WORSE THAN OTHER DEBTS

Bankruptcy legislation places home loans at a significant disadvantage when compared to vacation homes, investor properties and other debt by failing to provide common creditor protections. Congress did not create a loophole in the bankruptcy code for primary residences. In order to keep the cost of homeownership low, original legislative intent specifically left out the ability to cram down the debt owed on a primary residence. Current legislative proposals would eliminate — for home loans only — the requirement that modified debts be paid off within the three- or five-year term of the Chapter 13 plan. In fact, leading bankruptcy proposals would allow judges to obligate creditors to the modified terms for 30–40 years.

BANKRUPTCY LEGISLATION DISADVANTAGES SECURED CREDITORS

Today, home loans are granted priority over unsecured debt, such as credit cards. This is a fundamental principle of secured credit. Proposed legislation, however, erodes this principle. The current distinction granted to home loans does not mean borrowers lose their homes in bankruptcy. On the contrary, bankruptcy is used to reduce unsecured debts and other lesser priority debts to free up income to pay the secured home mortgage. Proposed legislation seeks to disadvantage secured home loan creditors by diverting the borrower's disposable income to pay unsecured debts.

CRAM DOWN LEGISLATION CANNOT BE COMPARED TO CIRCUIT COURT ACTION IN 1990s

Few home loans were crammed down in the 1990s. Only a few rogue courts interpreted the law to allow it and few borrowers could qualify for a cram down because the entire debt had to be repaid within the three- to five-year term of the Chapter 13 plan. Sufficient concern prompted Congress to hold hearings on these court rulings and introduce corrective legislation in S. 1985 (102nd Congress). The Supreme Court's *Nobleman* decision negated the need for corrective legislation.

HOW TO BETTER HELP BORROWERS

Servicers are already performing workouts at unprecedented levels. HOPE NOW reports almost 2.9 million loans have been modified or granted repayment plans (from June 2007 to November 2008). Additional borrowers have been helped through delinquent refinances, partial claims, and other loss mitigation tools. The belief that cram down legislation forces servicers to perform more modifications is misguided. Providing mortgage modifications is less costly, does less long-term damage to the borrower's credit, and rate modifications can actually reduce payments more than principal modification.



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