DATA SUPPORTING THE IMPLEMENTATION OF THE PRINCIPAL PAYDOWN PLAN

Proposed by the

National Association of Consumer Bankruptcy Attorneys

[Data: September 2011]

1. <u>How many mortgages could be modified under the Principal Paydown Plan</u>?

a. The Principal Paydown Plan would be available only to Chapter 13 debtors. Chapter 13 is a type of bankruptcy that is available to consumers and small business sole proprietors. It offers restructuring or discharging debt and paying back to creditors through the Chapter 13 plan, based upon the borrower's ability to pay. Chapter 13 cases usually last about three to five years. The Principal Paydown Plan could apply to pending Chapter 13 cases (that have already been filed), as well as new cases being filed.

(1) Current pending Chapter 13 cases (varies daily) - approximately 1,600,000 [1]

(2) Percent of pending Chapter 13 cases with mortgage claims – 55% [1]

(3) Nationwide Chapter 13 cases filed: [2]

12-mo Period	*# Total Bky Cases*	*# Total Ch 13 Cases*	*% Ch 13*
Jan-Dec 2010	1,593,081	438,913	27.6%
July 2010-June 2011	1,529,560	432,333	28.3%

(4) Likely pending Chapter 13 cases plus new ***cases that have mortgage claims***:

880,000 currently pending Chapter 13 cases with mortgage claims [1,600,000 x 55% = 880,000]

<u>plus</u> 1,188,916 additional Chapter 13 cases with mortgage claims to be filed during the next 5 yrs [432,333 x 55% = 237,783 x 5 yrs]

<u>equals</u> 2,068,916 Chapter 13 cases with mortgage claims expected to be pending during the next 5 yrs

There is no data available to determine what portion of Chapter 13 cases with mortgage claims are in current danger of foreclosure; however, that is a frequent reason for homeowners to file Chapter 13 cases.

b. Continued high Chapter 13 filings are likely in 2011 and 2012 due to economic factors, including:

(1) High nationwide unemployment rates – in a significant portion of bankruptcy cases, debtors cite income interruption as a major contributing factor in deciding to file bankruptcy. [6] [7]

January 2008	4.9%
January 2009	7.6%
January 2010	9.7%
January 2011	9.0%
August 2011	9.1%

(2) High consumer credit delinquency rates have traditionally accompanied high bankruptcy case filing rates and are now close to double the rate of ten years ago.

Type of Debt – % balance 90+ days delinquent (rounded) [9]	1Q:2000	1Q:2011
Credit Cards	7%	12%
Auto Loans	2%	5%

(3) High mortgage default and foreclosure rates also correlate with increased bankruptcy filings. The drop in average monthly new foreclosure filings between 2010 and August 2011 is due to the mortgage servicers' defensive posture with regard to the 50-State Attorney Generals' robo-signer settlement negotiations, and the decisions by some judges in judicial foreclosure states to invalidate robo-signed foreclosure documents. When the settlement negotiations are concluded (almost without regard to their outcome), the backlog of increasingly delinquent mortgages will refuel the foreclosure fire – at least in many states – and new foreclosure filings (starts) and sales are very likely to skyrocket to record highs.

Nationwide New Foreclosures		
Period	*Starts/Filings*	*Sales*
11-month period: 1-10 – 11-10	3,567,890	609,534
Monthly Average: 1-10 – 11-10	324,354	55,412
8-month period: 1-11 – 8-11	1,824,022	527,299
Monthly Average: 1-11 – 8-11	228,003	65,912
August 2011 – one month only	228,098	41,797

(4) The nationwide number of underwater properties has hovered around 10.9-11 million (22.5-24% of all residential mortgages) since 2009. An additional 2.4 million properties had less than 5% equity as of June 2011. [5] and [14] To compound the problem, over the four quarters ending with June 2011, the seasonally adjusted FHFA Housing Price Index dropped 5.9%. As prices continue to fall, many of these marginal properties will shift into the underwater category.

(5) Nearly 75% of underwater properties have loans with interest rates that are higher than market rate, meaning that the borrower makes less progress in paying down negative equity. [14]. This double-whammy of high interest and negative equity diminishes the ability of homeowners to pay their monthly home loan payments and will drive more of them to file Chapter 13 cases in attempts to save their homes.

c. States with high foreclosure rates correlate with high bankruptcy filing states – the overlapping populations result in a high proportion of homeowners in foreclosure also filing Chapter 13 or likely to file Chapter 13. Note that, for example in California, the number of pending Chapter 13 cases with mortgage claims was equal to about 67% of the number of foreclosure sales that occurred during the measured time period (118,800 divided by 176,661). While not all of those homes could have been saved from foreclosure if the Principal Paydown Plan were adopted, we believe that a significant percentage of them could have been.

States With the Highest Numbers of Foreclosure			*[Jan-Nov 2010: 11 mos]*
State	*New foreclosure starts/filings*	*Foreclosure sales*	*Est pending Ch 13 Cases w/ mtg clms*
California	779,531	176,661	118,800
Florida	568,531	104,084	52,800
Michigan	204,925	30,147	18,480
Illinois	180,480	20,830	36,960
Arizona	180,078	54,350	14,080

d. Adding it all up – what does it all mean?

(1) Homeowners with mortgage claims in about 2 million Chapter 13 cases could be eligible to save their homes from foreclosure over the next five years.

(2) Economic conditions indicate the continuing need for Chapter 13 bankruptcy relief for homeowners and the likely continued high filing rate.

(3) High Chapter 13 filing rates occur in states with high foreclosure rates, making Chapter 13 an appropriately targeted mechanism for enabling families to save their homes from foreclosure.

2. <u>Why would mortgages modified under the Principal Paydown Plan be more likely to be viable in the long-term than mortgages modified under current programs</u>?

a. HAMP program attributes have contributed to its poor performance.

(1) HAMP regulations, while well-intentioned, have not been enforced by the Administration, which has resulted in improperly denied applications and the approval of inadequately modified loans with grossly unaffordable payments.

(2) The fact that principal reduction is not mandated in the program works against its success. Media attention given to servicers' promises of principal reduction modifications have led to high borrower expectations that underwater mortgages are likely to be granted principal reductions. Those borrowers who are even offered modifications are then discouraged by servicer offers that do not include principal reduction.

(3) In most HAMP modifications (without principal reduction), the ***slower*** principal paydown (amortization) and possible balloon payments inherent in the HAMP program discourage borrowers because the prospect of earning equity in the foreseeable future is so remote.

(4) Except for borrowers who have filed bankruptcy, the back-end debt-to-income ratio (monthly debt payments including HAMP-modified first mortgage, junior mortgages, car loans, credit card debt, etc.) is extremely high, 61.6% [11]. This jeopardizes the borrowers' ability to maintain the HAMP payments post-modification.

(5) The inability of the borrower to include unemployment benefits as income in the 31% calculation [12] results in lower monthly HAMP payments calculated for (partially) unemployed households, which in turn is more likely to produce negative net present value results and consequently cause the HAMP application to be denied.

(6) Permanent HAMP modifications ***started*** have been declining. [11]

Permanent HAMP modifications started in July 2011	28,328
Percent decline in monthly permanent modifications since peak month (April 2010 = 68,291)	59%
Program total permanent HAMP modifications ***started*** through July 2011	791,399

(7) The substantial re-default rate after permanent HAMP modification is granted is rising dramatically. [11]

Program total permanent HAMP modification cancellations through July 2011	115,952
Program total percent of permanent HAMP modifications cancelled (cumulative)	14.7%
Total number of permanent HAMP modifications canceled in the month of July 2011 alone	9,925

b. Refinancing programs have not significantly addressed the problem of underwater mortgages.

(1) HARP refinancings are owner-occupied Fannie-refinanced-to-Fannie and Freddie-refinanced-to-Freddie first mortgages with no cash out to the borrowers. [4]

Total nationwide HARP refinances for loans that are measurably underwater have been insignificant in light of the magnitude of the problem.

Total HARP Refinances from April 2009 (inception) through June 2011

>80% - 105% loan-to-value ratio	776,009
>105% - 125% loan to value ratio	62,432
Cumulative program total	838,441

(2) FHA programs

FHA Loss Mitigation Interventions *[all]*, total from April 2009 through June 2011 [5]	938,800

c. "Proprietary" mortgage modifications (e.g., repayment plans, forbearance plans, HOPE Now, etc.), which are sometimes offered in lieu of HAMP modifications, are usually of little value to the borrower and usually include little or no principal reduction. Consequently, they usually fail to make the loan significantly more affordable for the borrower and do not address the "underwater" issue.

d. Chapter 13 offers considerable advantages in saving homes from foreclosure, particularly if combined with the Principal Paydown Plan.

(1) "Wholly unsecured" junior mortgages (those that attach to <u>no value</u> in the borrower's home) ***are currently being wiped out*** in Chapter 13 cases under normal circumstances, protecting the priority and viability of senior mortgages. These junior mortgages are a significant impediment to loan modification programs currently in place. However, bankruptcy law does not provide for modifying ***first mortgages secured by the***

borrower's principal residence – and that is why implementation of the Principal Paydown Plan is necessary.

(2) The back-end debt-to-income ratio is significantly reduced based upon the borrower's ability to pay, by often wiping out most of the borrower's credit card and medical debt, as well as wholly unsecured junior mortgages. This makes mortgage modifications under the Principal Paydown Plan much more likely to succeed than those under currently available modification and refinancing programs.

(3) A federal bankruptcy judge reviews and approves the Chapter 13 plan, and the Chapter 13 trustee supervises plan implementation.

(4) The stigma of filing bankruptcy and the court review of the plan and strict budget oversight would prevent undeserving borrowers from utilizing the Principal Paydown Plan.

3. How would taxpayers and private mortgage investors financially benefit from the Principal Paydown Plan?

a. Taxpayers and private mortgage investors would financially benefit from the Principal Paydown Plan by the transformation of currently (and anticipated) nonperforming underwater loans into performing loans – with no principal writedown. The reduction of the borrower's interest to 0% is temporary and the loan will revert to market interest rate (Freddie Mac rate) at the end of five years. The detriment (to the taxpayer/investor) of the temporary reduction of interest is more than offset by: the rapid improvement in the loan-to-value ratio; the re-start in payment performance by the borrower; and the elimination of many junior mortgages and the overall improvement in the homeowner's back-end debt-to-income ratio through the Chapter 13 court process.

(1) Fannie Mae, Freddie Mac, and FHA/VA loans currently or likely to be delinquent or in foreclosure could be saved from foreclosure if the Principal Paydown Plan is implemented. The actual numbers saved would depend on the degree of agency support for the program. It is likely that a substantial portion of the delinquent/foreclosure loans shown below are already in pending Chapter 13 cases and could be converted into Principal Paydown Plans without delay.

GSE & FHA Loans – 30+ Days Delinquent (not in foreclosure)		
Loan Type	*#*	*%*
GSEs – June 2011 [4]	3,078,000	10.39%
FHA – July 2011 [5] [16]	1,039,579	11.5%

(2) Subprime loans currently or likely to be delinquent or in foreclosure could be saved from foreclosure if the Principal Paydown Plan is implemented. The portion of these loans that could be converted to Principal Paydown Plans will, again, depend on the degree of support from investors and investor groups. It is probable that many of these loans are also in pending Chapter 13 cases.

Subprime mortgages - estimated [16]	4,094,189
% 90+ days delinquent [5] [16]	42.6%

(3) More than 40% of seriously delinquent (90+ days and prior to foreclosure start) have been non-performing for more than a year. [16]. These loans are unlikely to be converted into performing loans unless a loan modification capitalizes a substantial arrears amount – transforming many loans with marginal equity into clearly underwater loans. The Principal Paydown Plan could provide a way out for these homeowners, allowing them to pay down rapidly on the negative equity and stay out of foreclosure.

b. The cost/benefit effects to the taxpayer/investor if the Principal Paydown Plan is implemented are positive compared with the results if the property is foreclosed.

(1) Economic costs of foreclosure sales:

(a) Extended periods of delinquency usually lead up to the actual foreclosure sale. Borrowers' loan payments are often intermittent during the period of escalating delinquency. More loans are becoming seriously delinquent (see ¶ a above) before the foreclosure process is started. Depending on applicable state law, the foreclosure process can take many more months or even years. It is common for payments to have ceased more than a year prior to the actual foreclosure sale. Cash flow to investors ceases completely during this period.

(b) Without question, foreclosure sales produce lower sales prices than voluntary sales. Various studies have attempted to quantify this difference, resulting in estimates of a 22-50% reduction in price for a foreclosure sale. [15]

(c) If no third party purchases the property at the foreclosure sale, the investor will acquire title to the property and then re-sell it to a new buyer. Properties taken back by investors have languished unsold for extended periods of time during the last several years. In this situation, the foreclosing investor incurs the cost of real property taxes, insurance, homeowners association fees, managing, maintaining the property, and ultimately repairing it to bring it into the condition necessary to sell it. The actual sale will require the payment of real estate brokers' fees. During the period of abandonment the foreclosed property will further depress the values of surrounding properties.

(2) Economic benefits of modifying a loan under the Principal Paydown Plan:

(a) The Principal Paydown Plan will immediately restart monthly payments on the loan (and cash flow), immediately terminating the extended period of payment default.

(b) There will be no loss of principal for the taxpayer/investor.

(c) The modification will greatly increase the likelihood the borrower will stay in the home because of the enhanced ability to acquire equity.

(d) The loan will revert to market rate in five years.

c. "Trickle-up" positive consequences of implementing the Principal Paydown Plan include:

(1) Mortgages modified under the Principal Paydown Plan will help stabilize home values in the surrounding neighborhood. The "spillover effects" of foreclosure sales and abandoned homes on property values in the surrounding neighborhood would be reduced.

(2) Servicers and investors will be incentivized to more aggressively offer modifications with substantial benefits to borrowers, in order to dissuade them from filing Chapter 13 bankruptcy. This result will assist all affected parties.

Sources:

[1] Chapter 13 National Data Center, November 2010, averaged and rounded, based upon daily data
[2] Administrative Office of the U.S. Courts, Bankruptcy Filing Statistics
[3] Federal Reserve Bank of New York Consumer Credit Panel, Credit Conditions
[4] Federal Housing Finance Agency, *Foreclosure Prevention & Refinance Report – Second Quarter 2011*
[5] U.S. Department of Housing and Urban Development & U.S. Department of the Treasury, *The Obama Administration's Efforts To Stabilize The Housing Market and Help American Homeowners*, July 2011
[6] U.S. Bureau of Labor Statistics
[7] Congressional Budget Office, *Employment and Labor Markets – November 2010*
[8] Mortgage Bankers Association, *Mortgage Finance Commentary: December 2010*
[9] Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit – November 2010*
[10] RealtyTrac.com, December 2010 & September 2011
[11] U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through July 2011*
[12] U.S. Department of the Treasury, *Supplemental Directive 10-04* [HAMP, effective 8-1-10]
[13] Frame, Scott (Federal Reserve Bank of Atlanta), Andreas Lehnert (Board of Governors of the Federal Reserve System), Ned Prescott (Federal Reserve Bank of Richmond), *Snapshot of Mortgage Conditions with an Emphasis on Subprime Mortgage Performance*, working document for Federal Reserve's Home Mortgage Initiatives coordinating committee, August 27, 2008
[14] CoreLogic, *New CoreLogic ® Data Reveals Q2 Negative Equity Declines in Hardest Hit Markets and 8 Million Negative Equity Borrowers Have Above Market Rates*, September 13, 2011
[15] Frame, W. Scott, *Estimating the Effect of Mortgage Foreclosures on Nearby Property Values: A Critical Review of the Literature*, Federal Reserve Bank of Atlanta Economic Review, Volume 95, Number 3, 2010
[16] Lender Processing Services, *LPS Mortgage Monitor: August 2011 Mortgage Performance Observations*