

Sen. Durbin Makes the Case for Judicial Mortgage Modification in Chapter 13

Editor's Note: *Included here are excerpts from the Feb. 28 statement of Sen. Richard Durbin (D-Ill.) at the opening of Senate debate on legislation to give bankruptcy judges the authority to modify residential home mortgages in chapter 13. Sen. Durbin is the lead Senate sponsor of the legislation. Consideration of the bill failed later that day on a procedural vote, as the sponsors fell well short of the 60 votes needed to cut off a move to block the legislation. Senate Majority Leader Harry Reid (D-Nev.) vowed to resurrect the legislation at a future date.*

The issue we want to move to is the housing stimulus package. We are expecting resistance from the Republican side of the aisle. They don't want to debate the housing issue facing America. That is a serious mistake. I hope enough Republican Senators will step forward and join us to initiate this debate about housing in America. Our economy is in trouble. The first indication we had was in the housing market. The housing market is very sick today.

Last Friday, Moody's Economy.com reported that 1 out of 10 homeowners in America are holding mortgages on homes where their debt is larger than the value of their home; 8.8 million homes in America are so-called underwater, as they say. That is the greatest percentage of homes in such a state since the Great Depression. Goldman Sachs estimates that by the end of 2008, as many as 15 million homes will be in that situation, almost double the number we know today. The Center for Responsible Lending estimates 2 and a quarter million homes may be lost to foreclosure in the next couple of years. Fitch Ratings has recently estimated that for subprime loans originated in the years 2006 and 2007, 50 percent of them could end up in foreclosure.

But the crisis goes beyond the families who have their mortgages foreclosed. Forty million American families who are currently making their mortgage payments, through no fault of their own, will see the value of their homes go down because of this housing crisis. Why? Because the value of your home is based on comparable sales in the neighborhood. When that neighbor two

blocks over has a distress sale, an auction, because his house is in foreclosure and the house sells for less than fair market value, that is a calculation that affects the value of your home. Make your mortgage payments and still lose value in your home; that is what is happening.

So when we hear from some people that this is a narrow problem for a narrow group of people, trust me, it goes, unfortunately, way beyond. This housing crisis is our wake-up call. If we do not rally on a bipartisan basis and do something about it, the economy is going to get worse. I do not say that with any sense of pride—just disappointment. Well, the question is, what are we going to do about it? There is one thing we can do that can make a big difference. We need to change the bankruptcy law.

Listen to this: If you are facing bankruptcy but you are not completely out in the cold—you have an income coming in—you go into something called chapter 13. You walk into bankruptcy court, and you say to the judge: "I am in trouble. I cannot pay my debts. This is my

prohibits the bankruptcy court from modifying the terms of the mortgage on your primary home. All they can do is foreclose. That is it. Does that make any sense? A home is something that virtually everybody brings into that court. It is the most important asset we ever own, and the mortgage cannot be modified in the bankruptcy court for your home.

This provision of law in our housing stimulus package changes that. But we narrow it very strictly. It only applies if you live in the home. This puts the speculators out of business. We do not want the speculators to benefit from this. Secondly, you have to qualify to get into bankruptcy court. You don't have any income, can't make it in there? You are not going to get into that court. They do a means test now to get you into bankruptcy court. Third, it has to not only be an existing mortgage—not prospective, not for those two years from now, three years from now, but right now—but it has to be one of these subprime mortgages. Then, what can the court do? The court cannot lower this new

Legislative Update

income. These are my assets. Here are my debts. Is there a possibility we can work out and renegotiate these so I do not lose everything?" So when you go in there, the judge takes a look at it and says, "well, let's bring in your creditors and sit down and see if we can work out some kind of payment arrangement so you don't lose everything and they don't lose everything through foreclosure."

One of the things they can do is take a look at your mortgages. Do you have a mortgage on a vacation home, a vacation condo, for example? Well, the bankruptcy court can take a look at that mortgage, bring in the creditor, modify the terms of the mortgage—change the length of the mortgage, for example—even change the amount paid on the mortgage, even change the interest rate on the mortgage. You can do that. You own a farm? Let's take the mortgage on the farm. The bankruptcy court can renegotiate the mortgage on the farm. The same thing with a ranch. But wait a minute, what about your home? The law

modified mortgage below the fair market value of the home. This protects the lender. Lenders are very lucky to get a fair market value out of a home that is sold at auction. But they are protected here. And judges can only reduce interest rates to the prime rate plus a reasonable premium for risk. All of these things taken into consideration give the court the opportunity to modify the mortgage on your home so you can stay there. It is treated just like a vacation home, just like a farm, just like a ranch. How many people will be affected by this? About a third of the people facing foreclosure. A third of those people will be eligible for this consideration.

I think the good news is this: When we pass this bill, pass this change in the law, it is an incentive for these banks and lenders to sit down before you get into bankruptcy and work out terms that you can live with. That is not happening today. These lending institutions just are not doing that.

continued on page 42

Legislative Update: Durbin Makes the Case for Mortgage Modification

from page 10

They will if this provision in the law is included. Now, who would oppose this? Think long and hard about it. It is a hard question, right? No. It is an obvious question. This change in the bankruptcy law is opposed by the Mortgage Bankers Association. Those same wonderful folks who brought us the subprime mortgage crisis oppose this change to allow people to stay in their homes—the same people. They do not want this change in the Bankruptcy Code to give people a chance to stay in their homes, even though it has been narrowed and modified to the point where it is really strict. Now, there is a Senator on the other side who wants to offer an amendment to give the mortgage bankers the last word in the bankruptcy court; in other words, that the mortgage bankers have to give permission before the court can modify the mortgage. Well, what is the point if they are going to have the last word? They have the last word right now. They can renegotiate a mortgage if they want to, but they are not doing it. They are not doing it on a voluntary

basis. Unless and until those mortgage bankers know this mortgage can be modified, they are not going to sit down and negotiate.

Well, there is a big argument that comes back from the mortgage bankers: “Oh, you know what is going to happen here. If you give a portion of these 600,000 people a chance to stay in their homes, we are just going to raise everybody’s interest rate across America.” Well, let me tell you something: That is a vacant threat. The Georgetown University Law Center did a survey and study of this proposed change in the Bankruptcy Code and said it would have zero impact on the cost of credit across America—zero.

So they can threaten all they want, but do they have any credibility? Does this industry have any credibility when we look at the mess we are in today? ■