Center for American Progress Action Fund

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The Honorable Mitch McConnell
Senate Republican Leader
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The Honorable Nancy Pelosi
Speaker of the House
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The Honorable John Boehner
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As you develop the **American Recovery and Reinvestment Bill of 2009**, please bear in mind that the housing crisis that lies at the heart of the current recession remains unsolved. The new administration, through the considerable authorities it already possesses under TARP, can do much, but not yet all, of what is needed to keep American families in their homes and prevent additional foreclosures from devastating communities and delaying an economic recovery. A narrow set of legislative tools is needed to complement the TARP authorities and accelerate the offer and acceptance of mortgage modifications and enhance foreclosure prevention.

Swift congressional action is needed to reduce the barriers that mortgage servicers assert are keeping them from modifying loans or offering them for sale to Treasury under TARP. Congress must modify the rules governing Real Estate Mortgage Investment Conduits, or REMICs, to make ongoing REMIC status (and favorable tax benefits) contingent on eliminating the artificial restrictions in pooling and servicing agreements that tie the hands of servicers who seek to make economically rational, NPV-positive modifications that benefit their investors as a whole. Additionally, the ongoing difficulty in getting servicers of securitized loans to offer meaningful modifications, coupled with several instances of actual and threatened litigation suggest that unless Congress provides adequate liability protections for servicers who act reasonably to prevent foreclosures, they may remain unwilling to modify troubled loans in a manner that leads to long-term sustainable homeownership for borrowers. Concurrently, technical changes are needed to increase the take-up and efficacy of the Hope for Homeowners program.

Even if servicers can be induced to offer meaningful modifications, however, borrowers must accept the offer. Many borrowers are fearful that accepting a meaningful modification will have severe negative tax consequences. Under current law, when a homeowner is provided with a loan modification containing a principal write-down or a significant interest rate reduction, the IRS considers the homeowner to have received taxable cancellation of indebtedness income unless the mortgage debt is “qualified” under the terms of the Mortgage Forgiveness Debt Relief Act of 2007 or the homeowner is insolvent. There are two major problems with this situation: First, taxpayers receiving a Form 1099 assume it means they must pay taxes on the debt forgiven and do not understand the rules and may therefore be unnecessarily fearful; and second, the 2007 act only applies to mortgage proceeds covering home purchase or improvement, and in many cases, borrowers used refinance proceeds for other purposes, such as higher education or to cover medical expenses. Congress should remedy this situation in which borrowers are refusing modifications that would help both them and their communities by amending the law to modify the definition of “qualified mortgage debt” to include all mortgage debt, not just acquisition or improvement debt.

If we have learned anything over the past year, it is that the current mortgage servicing system is so backed up and so complicated that there will be homeowners who are not offered, in a timely manner, loan modification that could keep them in their homes. Some of these families will take refuge in bankruptcy. It is time to modify the Bankruptcy Code to enable judges faced with this situation to judicially modify mortgages. This will give those relatively few homeowners who make the difficult decision to attempt a Chapter 13 reorganization of their finances the opportunity to save their homes. Perhaps more importantly, it will change servicer dynamics to encourage more voluntary modifications outside of bankruptcy.

Speeding mortgage modification is unquestionably stimulative, as the reduction in monthly debt obligations frees up much-needed income for basic goods: An interest rate reduction from 9 percent to 5 percent on a $150,000 mortgage would not only put over $4,800 back in an American family’s pocket each year, but would also significantly reduce the likelihood of default. Moreover, interest rate reductions also accelerate amortization schedules, allowing borrowers to build up equity in their homes faster. At a time when homeowners suddenly see their cushions of home equity evaporating, reversing the declines in wealth will also stabilize consumer confidence and behavior. Likewise, cleaning up these troubled assets, which are also impeding the health of financial institutions, will assist in shoring up balance sheets and thus benefit the broader economy. These strong stimulative effects present a solid case for including this legislation in the American Recovery and Reinvestment Bill rather than delaying consideration for future housing legislation.

Decisively addressing the housing crisis will require a collaborative effort between Congress and the administration. The problem’s complexity argues for maintaining the flexibility needed to pursue multiple approaches through multiple channels simultaneously. We must leverage the capacity of the private sector to voluntarily make standardized loan modifications while simultaneously using TARP to acquire and restructure troubled mortgages. These efforts should also be accompanied by expanded refinancing opportunities driven by market conditions as well as the opportunity for relief in bankruptcy.

The recovery can be speeded by restoring confidence in American families’ abilities to keep their homes and protect their home equity from further erosion. Preventing foreclosures will reduce downward pressure on home prices, in addition to precluding the high individual and social costs of increased homelessness. Just as the administration must use TARP for acquiring mortgage assets and restructuring them, Congress must quickly do its part to eliminate barriers to making widespread mortgage modifications possible.

Sincerely,

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