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SENATE REPUBLICAN POLICY COMMITTEE

Legislative Notice

No. 48 February 28, 2008

H.R. 3221 – New Direction for Energy Independence (a shell for S. 2636 – Foreclosure Prevention Act of 2008)

Calendar No. 340

H.R. 3221 was read twice and placed on the calendar on September 5, 2007.

Noteworthy

- At 4:55 p.m. today, the Senate will vote on cloture on the motion to proceed to H.R. 3221. **When the Senate begins consideration of the bill, it is expected that Senator Reid will offer the text of S. 2636, the Foreclosure Prevention Act of 2008, as a complete substitute to H.R. 3221.**

- In December 2007 housing starts fell to their weakest level since May 1991. As a whole, housing starts were down 24.8 percent in 2007, representing the second-largest decline on record, exceeded only by a greater decline in 1980. Home prices saw a decline of 8.9 percent in the final quarter of 2007, representing the largest year-to-year drop in the 20-year history of the index.

- Despite the fact that foreclosures are predominately limited to subprime ARMs, this issue is impacting the economy. In response to the slowdown in the economy, Congress, the President, industry, and the Federal Reserve have all taken action.

- The substitute provides an additional $10 billion of tax-exempt private activity bond authority to be used to refinance subprime loans, and provide mortgages for first-time homebuyers and multifamily rental housing.

- The substitute increases pre-foreclosure counseling funds by $200 million.

- The substitute adds $4 billion to Community Development Block Grants (CDBG) to purchase and rehabilitate foreclosed properties.

- The substitute changes the bankruptcy code to allow judges to modify a debtor’s mortgage (current law prohibits this).

- The substitute extends the carry back period for net operating losses (NOLs) from two years (2004) to 5 years (2001) for NOLs arising in tax years 2006, 2007, and 2008.

- The White House has issued a veto threat for S. 2636.

Background/Overview

While the U.S. economy continues to grow, the economy is no longer enjoying the robust growth it enjoyed over the past several years. The economy grew at an anemic 0.64 percent in the fourth quarter of 2007. Despite a relatively low unemployment rate (4.9 percent), economists are predicting a further slowdown in the short term.

The view of the economy is shared by consumers. Brought on by less favorable business conditions and job prospects, consumer confidence has been slowly declining since July 2007 and declined sharply in February, to its lowest reading since February 2003.[1] Another measure of consumers' view of the economy, the expectations index, has fared even worse, declining to a 17-year low earlier this month.[2]

The economic outlook has no doubt been affected by the increase in consumer prices. In 2007, led primarily by the increase in the cost of gasoline and food, consumer prices increased by 4.1 percent, their fastest rate in 17 years, on top of a 2.5 percent increase in 2006. At the same time however, weekly wages failed to keep up with inflation.[3] Over the past 12 months, wholesale prices have risen by 7.5 percent, which is the fastest increase since the fall of 1981 when the country was in recession.[4]

The housing market has also suffered. December 2007 housing starts declined by 14.2 percent, falling to their weakest level since May 1991.[5] As a whole, housing starts were down 24.8 percent in 2007, representing the second-largest decline on record, exceeded only by a greater decline in 1980. After 14 years of rising home prices, the housing market saw a decline, according to Standard & Poor's/Case-Shiller home price index. Home prices saw a decline of 8.9 percent in the final quarter of 2007, representing the largest year-to-year drop in the 20-year history of the index.[6]

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[1] http://www.conference-board.org/economics/consumerConfidence.cfm See also, *Associated Press*, "Job Worries Sink Consumer Confidence," February 26, 2008. The Consumer Confidence Index fell to 75 in February 2008 from a revised 87.3 in January. This was the lowest reading the index has had since it was 64.8 in February 2003.

[2] *Associated Press*. The expectations index measures consumers' outlook over the next six months. The index dropped to 57.9 from 69.3 in January. The index has not registered this low since 55.3 in January 1991.

[3] *Associated Press*, "Gas, Food Spur Inflation Jump in 2007," January 16, 2008.

[4] *Associated Press*, "Wholesale Prices Jump in January," February 26, 2008.

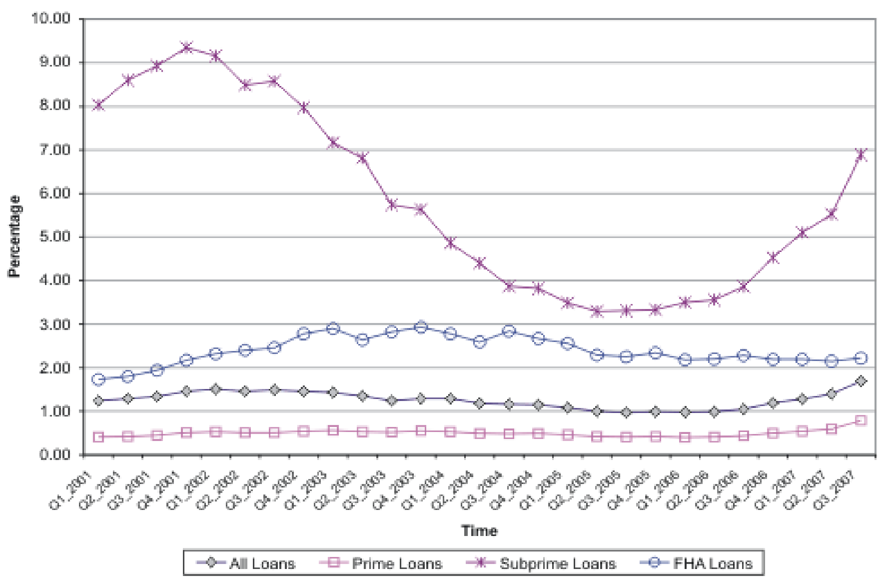
[5] Breitbart.com, "US Housing Starts Plunge 14.2 Percent," January 17, 2008. Housing starts fell to an annualized level of 1.006 million properties, down from the forecast of 1.150 million units.

[6] *Los Angeles Times*, "U.S. Home Prices End 2007 With Record Drop," February 27, 2008.

Despite these short term declines, not all housing data is negative. According to the Census Bureau, homeownership rates were still near an all-time high at the end of 2007. Nearly 75.2 million homeowners, or 67.8 percent of households, are living in homes they own.[7] Of the families living in owner-occupied homes, nearly one-third (or 24 million) own their homes free and clear of any mortgage indebtedness while two-thirds (51 million) of homeowners have a mortgage.[8]

The Mortgage Bankers Association's tracking of 41 million mortgages shows that foreclosures among prime loans and Federal Housing Authority (FHA) loans has stayed relatively constant from the beginning of 2001 through the Third Quarter of 2007. Data shows that the slight increase in foreclosure rates is due in large part to the rise in foreclosure rates with subprime loans (a rate which is still lower in Q3, 2007 than it was at any point from Q1, 2001 through Q1, 2003).[9]

Percentage of Foreclosures by Aggregate Category



Additional data shows that among subprime mortgages that are in default, the increase in foreclosures is a result of subprime adjustable rate mortgages (ARMs). The foreclosure rate among subprime fixed rate mortgages (FRMs) has actually been in decline since 2002.

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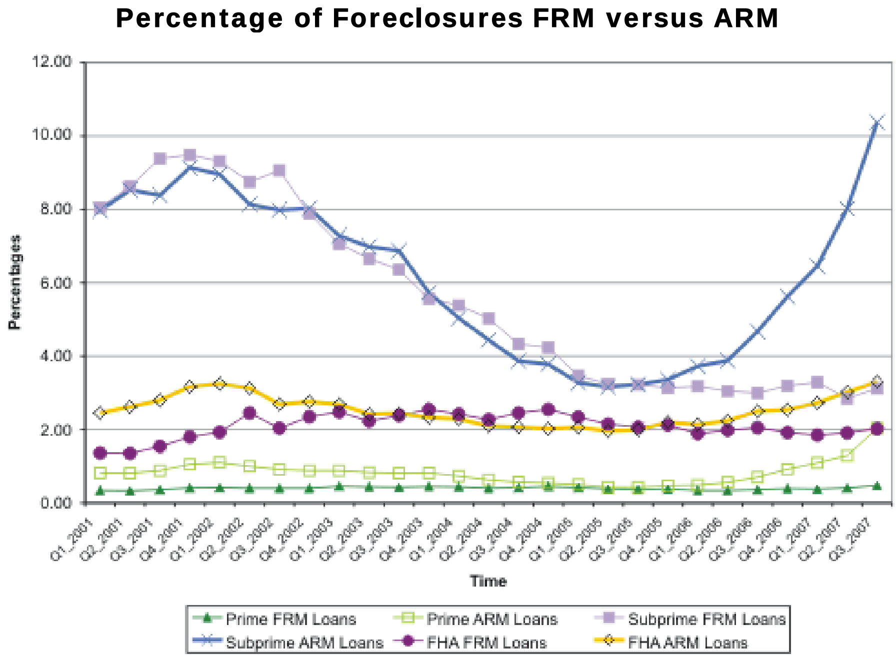
[7] Census Bureau's Housing Vacancy Survey, January 29, 2008.
http://www.census.gov/hhes/www/housing/hvs/qtr407/q407press.pdf
[8] Census Bureau's 2006 American Community Survey.
[9] Congressional Research Service (CRS), "Understanding Mortgage Foreclosure: Recent Events, the Process and Costs," CRS Report for Congress RL34232, January 14, 2008.



Despite the fact that the increase in foreclosures is predominately limited to subprime ARMs, foreclosures are impacting the economy as a whole. In response to the slowdown in the economy, Congress, the President, industry, and the Federal Reserve have all taken action. The collective response from the federal government includes:

- Multiple reductions in interest rates by the Federal Reserve;
- Enactment of H.R. 5140, the original stimulus bill, which raised the conforming loan limits for FHA, Fannie Mae, and Freddie Mac;
- Enactment of H.R. 3648, which became law on December 20, 2007, and extends mortgage insurance premium deductibility for three years and makes mortgage loan forgiveness non-taxable for a three year period;
- Proposal of Home Ownership and Equity Protection Act (HOPEA) regulations by the Federal Reserve, consisting of strong new regulations under HOPEA to greatly improve underwriting standards and protections for mortgage borrowers, regulations which will be finalized this spring; and
- Agreement by the private lending industry to participate in the HOPE NOW program (an effort to reach out to borrowers and offer assistance), and to participate in Project Lifeline (a targeted industry effort to reach out to seriously delinquent homeowners to offer a pause in the foreclosure process). Six major lenders, representing 50 percent of the mortgage market, are working with borrowers to help them stay in their homes under these programs.

State and local governments have also taken steps to assist borrowers who are in default. Many of these efforts, however, have been met with some resistance from citizens who view this assistance as a "taxpayer bailout." For example, in Seattle, a city with a relatively modest foreclosure problem, the city's plan of a $5,000 loan for people in danger of losing their home was met with opposition.[10] A loan program in Massachusetts, which allowed for loan

[10] *New York Times*, "Foreclosure Aid Rising Locally, as Is Dissent," February 26, 2008.

refinancing with bond revenue, was also met with public resistance. MassHousing, the quasi-state agency that was running the program, had to engage in a public-relations effort to assure citizens the effort was "not taxpayer funded." Commentators have stated that programs which involve "government intervention could reward irresponsibility and make markets unpredictable."[11]

Bill Provisions

This Notice summarizes provisions of S. 2636, the Foreclosure Prevention Act of 2008.

TITLE I - Modifications on Use of Qualified Mortgage Bonds

Expansion of Mortgage Revenue Bonds. The substitute provides an additional $10 billion of tax-exempt private activity bond authority to be used to refinance subprime loans, and provide mortgages for first-time homebuyers and multifamily rental housing. The proposal also exempts interest earned on the bonds from the alternative minimum tax.

TITLE II - Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes

Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes. The substitute adds an additional $4 billion to Community Development Block Grants (CDBG) to purchase and rehabilitate foreclosed properties. The historic spendout rate for CDBG is a 7 year spendout, in which 50 percent of these funds will be spent in the third year after enactment. Accordingly, the majority of these CDBG funds will not be spent until 2011.

TITLE III - Housing Counseling Resources

Housing Counseling Resources. The substitute increases pre-foreclosure counseling funds by $200 million. In the FY 2008 omnibus bill, $180 million was appropriated for pre-foreclosure counseling and that money has not yet been spent. Approved housing counseling agencies include, but are not limited to, Urban Leagues, ACORN, and Catholic Charities.

TITLE IV - Helping Families Save Their Homes in Bankruptcy Act

Subtitle A – Minimizing Foreclosures

Special rules for modification of loans secured by residences. In a nutshell, the substitute changes the bankruptcy code to allow judges to modify the principal terms of a debtor's mortgage (current law prohibits this) so that judges can reduce the principal balance of a loan and the rate of interest of the mortgage. The substitute authorizes a bankruptcy plan for individuals with regular income to: (1) modify an allowed secured claim secured by the debtor's principal residence if the debtor's income is insufficient to retain possession of the residence by curing a default and maintaining payments while the case is pending; (2) provide for payment of such claim for a period not to exceed 30 years; (3) permit the addition of certain costs to secured

[11] *New York Times.*

debt under specified circumstances; and (4) waive any prepayment penalty on a claim secured by a debtor's principal residence.

Industry experts estimate that the cost of allowing judges to modify a debtor's mortgage would substantially increase uncertainty for lenders thereby increasing the risk associated with making a mortgage loan. The costs associated with this increased risk would be passed on to consumers in the form of higher interest rates. The additional cost to consumers has been estimated to result in an interest rate increase of 1.5 to 2 percent.[12] Every quarter point increase in mortgage interest rates would prevent 1.1 million Americans from being able to afford a home. Accordingly, this change in the bankruptcy code could potentially prevent 9 million Americans from owning a home. This policy will cost the average American homebuyer an extra $60,000 in interest costs over the course of a 30-year mortgage (assuming the U.S. average home price of $166,000). In 2008 and 2009 alone, this provision will drive up mortgage interest rates for an estimated 11 million homebuyers.[13]

Waiver of counseling requirement when homes are in foreclosure. The substitute waives the counseling prerequisite upon certification that a debtor's principal residence is scheduled for foreclosure, even if the sale is not imminent. Currently, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) already allows a bankruptcy judge to waive the credit counseling requirement when a debtor describes "exigent circumstances" that merit such waiver and states that the debtor sought counseling from an approved non-profit counseling agency but was unable to receive such assistance within five days.

Subtitle B – Providing Other Debtor Protections

Combating excessive fees. The substitute adds a new Section 1322(c) (3) to BAPCPA to prohibit any fee, expense or charge from being added during or after the bankruptcy case in regard to any secured debt unless notice is provided within one year of such expense being incurred.

Maintaining debtors' legal claims. The substitute allows debtors to pursue claims and defenses against all consumer creditors, both secured and unsecured. The claims and defenses do *not* have to be listed as property of the debtor when bankruptcy was filed.

Resolving disputes. Authorizes the bankruptcy court, in certain proceedings involving an individual debtor with primarily consumer debts, to hear and determine the proceeding and to enter orders and judgments in lieu of arbitration. The provision would void legal arbitration in regard to both core and non-core proceedings for all consumer loans, both secured and unsecured, that become part of a bankruptcy proceeding.

Enacting a homestead floor for debtors over 55 years of age. Creates a principal residence homestead exemption for debtors over 55 years of age in the amount of $75,000.

Disallowing claims from violations of consumer protection laws. The substitute bars the claim of any lender for any violation of any provision of the Truth in Lending Act, as well as any

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[12] Mortgage Banker's Association, http://www.mortgagebankers.org/StopTheCramDown and
[13] http://www.mbaa.org/files/Bulletin/InternalResource/60108_.pdf

"applicable" state constitution, law or regulation. A similar provision was rejected in 2005 when Senator Durbin offered it as an amendment to BAPCPA.

TITLE V - Mortgage Disclosure Improvement Act

Enhanced Mortgage Loan Disclosures. The substitute amends the Truth in Lending Act (TILA) to set forth disclosure requirements governing certain extensions of credit secured by the dwelling of a consumer. In particular, it would require: (i) firm disclosure of the terms of the mortgage loan within 3 days of application and no later than seven days before closing and (ii) disclosure of the maximum loan payment under the loan, not only at application, but also no later than seven days before closing. It also would clarify that lenders are subject to statutory damages for violations of TILA disclosure provisions and increase the damages for mortgage violations from $2,000 to $5,000 per violation.

TITLE VI - Incentives for Business

Net Operating Loss. The substitute extends the carry back period for net operating losses (NOLs) from two years (2004) to 5 years (2001) for NOLs arising in tax years 2006, 2007, and 2008. NOLs are allowed to offset 100 percent of a taxpayer's alternative minimum taxable income. The provision allows money-losing businesses to seek refunds of taxes paid in recent profitable years. The Joint Committee on Taxation has estimated that the provision would cost the government $15 billion in fiscal year 2008 and $5.1 billion over ten years.

TITLE VII - Emergency Designation

The substitute is designated as an emergency and does not have to adhere to Section 204 of S. Con. Res. 21 (110th Congress). This means that the bill does not have to comply with PAYGO.

Administration Position

The Statement of Administration Policy (SAP) for this bill is as follows:

> The Administration understands that H.R. 3221 will be amended on the Senate floor by the substitution of the text of S. 2636, the Foreclosure Prevention Act of 2008, as introduced by Senator Reid. Earlier this month, Congress and the Administration worked expeditiously to pass the Economic Stimulus Act of 2008, a robust economic growth package that will put $152 billion into the hands of American individuals and businesses in FY 2008. When the President signed that Act, he stated that Congress can further assist the housing sector by passing legislation quickly to modernize the Federal Housing Administration (FHA) and reform regulatory oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. These bills have bipartisan support and are the appropriate next steps to address the housing downturn; Congress needs to make these important bills an immediate priority. As discussed below, the Administration strongly opposes many of the provisions in S. 2636 as unnecessary, costly, and counterproductive. If S. 2636 were presented to the President, his senior advisors would recommend he veto the bill.

The Administration strongly opposes the provision of S. 2636 that would appropriate $4 billion for assistance to State and local governments for the redevelopment of abandoned and foreclosed homes through a new program in the Department of Housing and Urban Development (HUD). In addition to being extremely costly, this new program would constitute a bailout for lenders and speculators, while doing little to help struggling homeowners. This new program would also be slow to expend money and thus would not provide timely stimulus or immediate relief. In fact, it is more likely that this proposal would prolong the time it would take for the housing market to recover.

The Administration also opposes more than tripling the funding for the Neighborhood Reinvestment Corporation (NRC) in FY 2008 from its FY 2007 funding levels. Such an increase would tax NRC's capacity to effectively administer its programs, given that NRC has already received a 156 percent increase from its FY 2007 funding level.

The Administration strongly opposes providing bankruptcy judges with power to modify the terms of mortgages for debtors in bankruptcy proceedings. Amending the bankruptcy code in this manner would undermine existing contracts, leading to contraction in mortgage credit availability and affordability. These and other bankruptcy-related provisions in the bill would rewrite long-standing tenets of bankruptcy law in ways that would fundamentally alter the expectations of parties to hundreds of thousands of home purchases after the fact. These provisions would also likely prolong the time it will take the market to recover from the current downturn.

Possible Amendments

It is expected that several amendments will be offered, if allowed, including a complete substitute by Senator McConnell, which would contain a set of policies to grow the economy, an amendment to create a $15,000 housing tax credit by Senator Isakson (similar to the text of S. 2566), an amendment to strike the bankruptcy provisions, and various iterations to make the 2001/2003 tax relief permanent.

Cost

At press time, there was no cost estimate available for S. 2636.