TESTIMONY OF WILLIAM E. BREWER, JR.

on behalf of the
NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

BEFORE THE UNITED STATES HOUSE JUDCIARY COMMITTEE
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

"Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress? – Part II"

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Chairman Sanchez, Ranking Member Cannon and member of the Subcommittee, thank you for the opportunity to appear before you today to testify on the need to enact legislation to help homeowners prevent the loss of their homes through foreclosure.

I am William E. Brewer, Jr. I practice law in Raleigh, North Carolina, as a sole practitioner, where I represent debtors in bankruptcy cases. I am a certified specialist in consumer bankruptcy law by the North Carolina State Bar Board of Legal Specialization and serve on the Board of Directors of the National Association of Consumer Bankruptcy Attorneys (NACBA). I appear today on behalf of NACBA, its more than 2700 members, and most importantly, their future clients who face the real prospect of losing their homes to foreclosure. My testimony comes from the perspective of consulting each and every working day with clients who come to me in hopes that I can help them hold on to the key ingredient of the American Dream, home ownership.

First, I want to commend you, this Subcommittee and your colleagues, Representative Miller and Representative Chabot, for recognizing the urgent need for immediate action to help distressed homeowners save their home from foreclosure. We are pleased to see that there now is clear recognition from both sides of the aisle in Congress that distressed homeowners need additional tools to save their homes from foreclosure and that America's long-established bankruptcy safety net should serve as an essential part of that solution. Second, I urge Congress to enact H. R. 3609. I will not repeat the testimony this Subcommittee has already received from other witnesses in prior hearings as to the nature and extent of the crisis in the home mortgage market that created the need for H.R. 3609 and the other similar bills introduced in the House and the Senate. Suffice it to say that home foreclosures are at historical high levels, and many of your constituents are destined to be put out of their homes if you do not take the appropriate remedial action.

Homeowners are trapped in high interest mortgages with payments that adjust upward to the point that they simply cannot afford to make them. Many of these loans are the adjustable rate loans that have original "teaser" rates that the borrowers can afford, but are set to adjust two years after the loan is made and every six months thereafter. The contractual provisions on these loans are such that substantial increases in payments are certain. However, the problem is not limited to adjustable rate loans. Many homeowners facing foreclosure executed fixed-rate, high interest loans with subprime lenders. Whether the looming foreclosure arises out of an adjustable rate or fixed-rate loan, the loss of the home is the same. Both types of borrowers need the help of Congress.

The most effective remedy available to homeowners facing foreclosure is to file a bankruptcy under Chapter 13 of the Bankruptcy Code to stop the foreclosure. Under existing law, for debtors to successfully utilize Chapter 13 to stop a foreclosure and keep their home, they must resume making their contractual mortgage payments upon the filing of the bankruptcy and "cure" (i.e., catch up) arrears in payments existing when the bankruptcy is filed. With respect to these high interest loans, whether adjustable or fixed-rate, existing law prevents a debtor from remedying the financial circumstance that created the problem in the first place, i,e., a mortgage payment that the debtor cannot afford to pay. This is so because section 1322(b)(2) of the Bankruptcy Code prohibits a debtor from modifying a loan secured solely by real property that is the debtor's principal residence. As this Subcommittee knows from the prior testimony, this prohibition on the modification of the terms of the loan is unique to loans on a primary residence. In the face of foreclosures at epidemic levels, the useful life of this provision has ended.

H.R. 3609 would allow a debtor to modify a home mortgage by reducing the amount of the debt to the fair market value of the property, if the property is worth less than the amount of the debt, and to pay that debt at reasonable rates in accordance with existing Supreme Court precedent. Similar bills pending in Congress also amend the anti-modification provision to a lesser degree. From the perspective of someone who must first advise clients as to their options under the law and then attempt to appropriately apply the law for the benefit of clients, I urge Congress to enact legislation that is not only clear in its meaning, but free of cumbersome conditions that create ambiguities in its application or hurdles in its implementation. Neither debtors, nor creditors, nor the courts are served well by legislation that creates needless issues to litigate. For Chapter 13 to function as it should, the process must be efficient and easy to implement.

It is my understanding that the mortgage lenders oppose this legislation. One might assume from that opposition that the enactment of this legislation represents a zero sum game – that is, every dollar saved by a debtor in modifying a home mortgage loan is a dollar lost by the mortgage lender. Such a circumstance would arise only if one assumes that in the absence of the modification, the homeowner would continue to comply with the contractual terms of the loan. From my experience of delving into the financial circumstances of these homeowners on a daily basis, I know that compliance with the terms of the loan is not one of the options. In the absence of the modification of the loan, the homeowner will eventually have to give up the home. Whether this "surrender" of the home occurs in connection with a Chapter 7 or Chapter 13 bankruptcy, or with no bankruptcy, the mortgage lender will eventually have to foreclose on the home. The time frame under North Carolina law in which the property can be foreclosed, with an intervening bankruptcy, is three to six months. The home will sell for no more than its fair market value. In fact, in most cases these homes sell for substantially less than the fair market value. (From my experience, homes sold in foreclosure generally sell for only 70-75 percent of the actual fair market value.) If the lender is the high bidder and purchaser at the foreclosure sale, it must then maintain the home until it can liquidate it and bear the costs of liquidation.

As intended, the homeowners will benefit from a newly-created right to modify home mortgages. They gain an enhanced opportunity to retain their homes. However, not so expectedly, the mortgage lenders will also fare better under these modifications. In the absence of the modifications, the mortgage lenders will suffer the substantial losses arising out of the scenario set out in the previous paragraph. Conversely, with the modifications of these loans the mortgage lenders receive a stream of payments at reasonable market rates for the entire debt or the value of the property, whichever is less.

The mortgage lenders' protestations that the bankruptcy law does not need to be amended to allow the modification of home loans because mortgage lenders are voluntarily working with homeowners to modify these subprime loans are hollow. First, it is far from clear that these “modifications” being offered by the subprime lenders are meaningful in substance. The mortgage lenders convinced the homeowners in the first place that they can afford to pay these subprime loans. It is certainly likely that they can convince these homeowners that they can comply with modification terms that are unrealistic and designed not to prevent, but only delay, the inevitable foreclosure.

Secondly, these voluntary modifications will reach only a small percentage of defaulting homeowners. To save their homes, the vast majority of these homeowners will have to resort to some remedy other than the mortgage industry’s voluntary modification programs. The mortgage industry created this financial “Titanic” via the fragmentation of the industry and the “securitization” of the home loans which allowed each segment to make profits and pass the risk up the line. Now that the ship has hit the iceberg, I submit that Congress should view with skepticism the industry’s contention that it has enough lifeboats to save the passengers.

Assuming for the sake of argument that my view of the effectiveness of the industry’s medication programs is wrong, and some significant portion of the these loans will in fact be meaningfully modified, the need to allow modification of home loans in bankruptcy still exists. Clearly, a significant portion of these homeowners will not successfully modify their loans outside of bankruptcy. They, too, deserve an opportunity to save their homes from foreclosure. If the industry is sincere about the desire to allow homeowners to save their homes through a modification of these subprime loans, it is difficult to understand why it opposes the modification of these loans through bankruptcy. What difference does it make whether the loan is modified through an industry created modification program or through a bankruptcy? In fact, the modification through the bankruptcy process will be the most cost effective and orderly means of modification. The debtors, through their payments of fees and costs for the bankruptcy, will bear the expense of the modification. The lenders will save the administrative costs, which must be significant, associated with evaluating, processing, and documenting modifications outside bankruptcy.

Another argument made by the industry is that to allow the modification of home loans in bankruptcy will create a flood of debtors, who are having no difficulty in meeting their obligations on their debts, who will file bankruptcy for the sole purpose of "refinancing" their home loans. The argument is unfounded. I have been representing debtors in bankruptcy proceedings for over 20 years, and I state without reservation that borrowers who can and who are meeting their financial obligations do not file bankruptcy to take advantage of bankruptcy laws that allow them to eliminate or modify financial obligations. Bankruptcy remains the refuge of last resort for those who can't pay their debts. Today, the bankruptcy law allows people to modify their car loans by reducing the amount of the debt to the value of the vehicle and the interest rate to a reasonable rate. Yet, I have *never* had a car owner come to see me about filing bankruptcy saying, "Mr.Brewer, I am having absolutely no difficulty in paying my car loan and other debts, but I heard that I might be able to reduce my car loan payments if I file bankruptcy. I would like to do that." There is no good reason to believe that homeowners will be induced to file bankruptcy just to obtain lower mortgage payments.

Likewise, the mortgage lenders' argument that the right to modify home mortgages in bankruptcy will increase the costs of home mortgages to everyone and detrimentally "dry up" mortgage loans, appears to be a stretch. First, the percentage of loans that will ever be modified in bankruptcy, as a percentage of the total mortgage loans written, is so small that the effect will be *de minimis*, Secondly, when viewed through the prism of the effect that the right in a bankruptcy to modify loans secured by other types of collateral has had on the cost and availability of such loans, the argument loses any remaining persuasiveness. Loans on investment property can be modified, yet those loans are available. I don't know of anyone ever suggesting that the rates on these loans have been increased because of the fact that they can be modified in a bankruptcy. The same can be said of car loans, which also may be modified.

With every loan there is a risk of default, and through the underwriting process that assessed risk is a component of the interest rate charged for the loan. Sometimes the default results in a bankruptcy, but bankruptcy does not *create* the risk of default or the loss arising out of the default. Bankruptcy laws do have an impact on how the debtor and creditor sort out the effect of the default. As established earlier in my testimony, the ability to modify a defaulted home loan in bankruptcy in most cases decreases rather than increases the mortgage lenders loss. Therefore, the argument that the ability to modify loans increases the risk of loss and the rate of interest does not withstand scrutiny.

Bankruptcy relief, especially relief through Chapter 13, is about second chances and preserving assets essential for debtors and their families to maintain a dignified life. No asset is more essential than the home. In fact, obtaining and retaining a family's home is the American Dream. In the absence of the enactment of this legislation, many of your constituents will be victims of a cruel hoax—a hoax in which home ownership was but a temporary illusion.