MORTGAGE MODIFICATION MELTDOWN: WHEN WILL CONGRESS TAKE THE PLIGHT OF HOMEOWNERS SERIOUSLY?

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INTRODUCTION

"Neither a borrower, nor a lender be,"[1] warned Shakespeare, but borrowing and lending is now a robust and lucrative industry within our modern economy. Yet even today, powerful lenders must be kept under the close watch of state and federal regulators in order to protect the inexperienced borrower. This Note analyzes the Helping Families Save Their Homes Act of 2009 (hereinafter "Homes Act"),[2] which amends the Truth in Lending Act of 1968 (hereinafter "TILA"),[3] to create a safe harbor from liability for servicers in connection with entering mortgage loan modifications and other loss mitigation plans. The Homes Act also amends the Hope for Homeowners[4] program by attempting to provide greater incentives to mortgage servicers to modify existing mortgages instead of resorting to foreclosure. Further, it creates a new disclosure requirement that must be provided to borrowers by purchasers and assignees of residential mortgages in the secondary mortgage market.

Since 2007, over two million families have lost their homes, and studies show that many more millions will lose theirs over the next several years.[5] Even though the crisis has impacted all people across the United States, Hispanic and African-American communities have been considered the "ground zero" of this economic catastrophe, and this problem is coupled with the fact that minorities have generally suffered the greatest job losses as well.[6] Although Congress and the mortgage servicing industry have attempted loan modification reform in the past, many of these efforts have not produced effective results.[7] As part of a

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1 WILLIAM SHAKESPEARE, HAMLET act 1, sc. 3.

2 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, 123 Stat. 1632.

3 15 U.S.C. § 1601 (2010).

4 12 U.S.C. § 1715z-23 (2009).

5 ROD DUBITSKY ET AL, CREDIT SUISSE, FORECLOSURE UPDATE: OVER 8 MILLION FORECLOSURES EXPECTED 1 (2008); *About IFLA*, INST. FOR FORECLOSURE LEGAL ASSISTANCE, http://www.foreclosurelegalassistance.org/about (last visited Oct. 25, 2010).

6 Conor Dougherty & Miriam Jordan, *Recession Hits Immigrants Hard*, WALL ST. J., Sept. 23, 2009, at A10; Michael Powell & Janet Roberts, *Minorities Affected Most as New York Foreclosures Rise*, N.Y. TIMES, May 15, 2009, at A1.

7 PENN INST. FOR URBAN RESEARCH, RETOOLING HUD FOR A CATALYTIC FEDERAL GOVERNMENT: A REPORT TO SECRETARY SHAUN DONOVAN 15 (2009) [hereinafter

multi-pronged approach to combat the foreclosure crisis, the Homes Act adds incentives and extra pressures to encourage mortgage servicers to modify loans, instead of foreclosing on residential property. These provisions involve protecting servicers from TILA liability if they enter into "qualified loss mitigation plans" with homeowners, creating additional TILA disclosure requirements to increase transparency in the secondary mortgage market, and offering payments to servicers if they refinance mortgages in cooperation with the Department of Housing and Urban Development (hereinafter "HUD") through the Hope for Homeowners program. A judicial approach to the foreclosure crisis is also important, but in passing this bill Congress rejected Senator Dick Durbin's proposed amendments to the Bankruptcy Code that would have allowed U.S. Bankruptcy Judges to modify residential mortgages in the face of impending foreclosure.[8]

It is critical for the federal government and mortgage industry to follow through with this legislation that increases consumer ability to modify home mortgages, in addition to promoting potential judicial mortgage modification authority, in order to stabilize the U.S. housing market. Other strategies for mitigating the foreclosure crisis include promoting the spread of financial information, making significant improvements to the standard mortgage contract, and developing new financial consumer products to reduce the strain upon homeowners who face periods of financial distress.

This Note starts by addressing the background of the U.S. home mortgage crisis that began in the latter half of 2007, and continues as of the date of this publication. There follows an examination of a few of the major types of mortgages that exist today, some important past legislation regarding home mortgage lending, and previous failed attempts at reform. Next, this Note analyzes the Homes Act to see if it offers a better source of reform, and compares it to a piece of parallel state legislation from New Jersey. This Note concludes by recommending other avenues for home mortgage modification and reform, including the potential for judicial modification via bankruptcy court, and modern pro-consumer financial products that might alleviate the distressful situation affecting millions of Americans today.

RETOOLING HUD]; *About IFLA*, *supra* note 5.

[8] 155 CONG. REC. S4915, 4917-4918 (daily ed. Apr. 30, 2009) (statement of Sen. Dick Durbin).

I. BACKGROUND OF THE HOME MORTGAGE CRISIS

It is a scary thought that, as a result of foreclosure, one woman, Sheri West, lived out of her car and used her old backyard as a toilet.[9] As a result of significant high-interest credit card spending, West and her husband (now ex-husband), of Cleveland, Ohio, were left with a sizeable mortgage on their home despite many years of timely payments.[10] Because both she and her ex-husband held jobs, she could not continue payments on her single salary after her divorce, and instead accepted a cash payment of $2500 from the mortgage company to move out of the house she lived in for nearly ten years.[11] Though forced to move between friends' and relatives' homes, homeless shelters, and her car, she still "want[s] to eventually own a house again. . . .That's the American dream. That's what everybody wants."[12]

Two schoolteachers in San Diego, California only expect to make payments on their "interest-only" mortgage until 2013, at which time the monthly payments will increase by 20%.[13] This type of home mortgage allows homeowners to pay only interest for the first ten years, but the principal must be paid off in the next twenty years (instead of the usual thirty), resulting in a higher monthly payment during the principal payment period.[14] The schoolteachers decided to cut out home repairs in order to reduce their spending, as they search for a way to modify the terms of their mortgage agreement.[15]

In some of the country's weakest economic communities, such as Newark, New Jersey, over 1800 homes were in foreclosure by late 2008, mainly as a result of a 60% subprime mortgage rate in the city.[16] Minority consumers in low-income areas, like most Newark residents, often have severely restricted access to home loans at affordable prices

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9 Peter S. Goodman, *Foreclosures Force Ex-Homeowners to Turn to Shelters*, N.Y. TIMES, Oct. 19, 2009, at A1.

10 *Id.*

11 *Id.*

12 *Id.*

13 David Streitfeld, *As an Exotic Mortgage Resets, Payments Skyrocket*, N.Y. TIMES, Sep. 9, 2009, at B1.

14 *Id.*

15 *Id.*

16 Jeffery C. Mays, *Boarded-Up and Foreclosed, Houses Await Action by Newark and Partners*, N.Y. TIMES, May 17, 2009, at NJ13.

with beneficial terms.[17] Instead, mortgages offered to "lower-income and credit-impaired borrowers have higher interest rates and less favorable terms than the conventional prime loans that serve the mainstream market."[18] The dearth of easily accessible financial information in these communities, in addition to most residents' general lack of financial sophistication, may cause minority borrowers to depend on local mortgage brokers, instead of shopping for lower-cost loans or using cheaper, internet-based institutions.[19] Part of this Note will address the fact that certain minority groups, which have lower financial literacy skills and decreased access to consumer education, often obtain less-favorable subprime loans.[20]

From 1997 to 2005, homeownership rates in the United States steadily increased for all age, racial, and income groups and geographic regions.[21] The largest increases in homeownership rates were among people aged thirty-five and under with below-median income, and also among Hispanics and African Americans.[22] The three-fold combination of aggressive mortgage lenders, home value appraisers, and complacent borrowers initiated the chain reaction leading to the home mortgage crisis.[23] Mortgage originators sold off loans to securitizers, and therefore stopped worrying about the great risks involved with indigent borrowers. Furthermore, these originators made virtually no effort to determine borrowers' ability to repay the loans and rarely verified borrowers' income with the IRS, even if they had signed the authorization forms.[24]

Such questionable tactics may have also had a subtle discriminatory component that created a disproportionately negative

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[17] William Agpar & Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, *in* THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA 102 (Xavier De Souza Briggs, ed., 2005).

[18] *Id.*

[19] FURMAN CTR. FOR REAL ESTATE AND URBAN POLICY, N.Y.U. SCHOOL OF LAW, THE HIGH COST OF SEGREGATION: EXPLORING THE RELATIONSHIP BETWEEN RACIAL SEGREGATION AND SUBPRIME LENDING 3 (2009).

[20] *Id.*

[21] ROBERT J. SHILLER, THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT 5 (2008).

[22] *Id.*

[23] *Id.* at 6.

[24] *Id.*

impact on minority homeowners and their communities,[25] as noted by a racial gap between white and minority borrowers in the home mortgage market.[26] In 2001, lending at prime rates accounted for approximately 75% of all home mortgage lending to whites, but less than 50% of lending to Hispanics, and only 40% of lending to African Americans.[27] As a result of such lending practices, certain groups were forced to the subprime markets. Thereafter, homes are lost because of poor or unreasonable mortgage terms, credit is crippled, the chances of receiving a future home loan decrease, and the cost of credit for other important purposes increases.[28] The foreclosed homes remain vacant for long periods of time and become targets for criminal activity, thereby discouraging families or new businesses from moving into the community.[29] In an area like Newark, where there is already a long history of community instability, high foreclosure rates further stigmatize the city and its residents.[30]

A. Types of Home Mortgages in the U.S. and Delinquency Rates

There are three primary types of home mortgages, and this categorization relates to the final investor in the mortgage.[31] The first type is a note held in a bank or thrift portfolio, where mortgage holders have an undivided interest in the notes, giving them a significant amount of freedom to modify mortgages to meet a homeowner's financial situation.[32] Because these entities own the mortgages and therefore have a direct financial interest in avoiding foreclosure, they are in the best position to identify potential solutions, such as loan principal reduction and efficient refinancing strategies.[33] However, a bank or portfolio's disincentive to modification is the immediate write-down of value in these assets, resulting in a reduction of net income for

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25 Agpar, *supra* note 17, at 111.
26 *Id.* at 109.
27 *Id.*
28 *Id.* at 118.
29 *Id.*; Mays, *supra* note 16.
30 Agpar, *supra* note 17, at 118; Mays, *supra* note 16; *see also* N.J. STAT. ANN. § 46:10B-37(h) (2008).
31 RETOOLING HUD, *supra* note 7, at 20.
32 *Id.*
33 *Id.*

the mortgage holder.[34] This category of mortgages comprises approximately 27% of all outstanding mortgage debt and has a 10% delinquency rate.[35]

The second type of home mortgages are those held by the Federal National Mortgage Association (hereinafter "FannieMae") and the Federal Home Loan Mortgage Corporation (hereinafter "FreddieMac"), two government sponsored enterprises.[36] As a result of the Treasury Department's intervention in September 2008, the federal government effectively operates these two home loan entities and may be in a favorable position to initiate creative solutions to deal with the mortgage crisis.[37] This category of mortgages comprises approximately 51% of single-family mortgages nationwide, and carries a 17% delinquency rate.[38]

The last major category of home mortgage are those held in private label securities (hereinafter "PLS").[39] These mortgages, most originated as subprime or through Alt-A terms,[40] have been sold into private securitization trusts, and are the most difficult to address because they are bundled together in private securities.[41] Further problems arise because potential solutions have been complicated by recent litigation,[42] such as *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Financial Corp.*,[43] discussed *infra*. This category of mortgages consists of only about 16% of outstanding mortgage debt, but has a staggering 58% "serious delinquenc[y rate]."[44]

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34 *Id.*

35 *Id.*

36 *Id.*

37 RETOOLING HUD, *supra* note 7, at 20.

38 *Id.*

39 *Id.*

40 Alt-A mortgage loans are somewhat risky mortgages where a borrower is unable to provide "complete documentation of his assets or the amount or source of his income." MARK ADELSON, NOMURA FIXED INCOME RESEARCH, A JOURNEY TO THE ALT-A ZONE 1-2 (2003), *available at* http://www.securitization.net/pdf/nomura_journey_060303.pdf. In addition to this typical Alt-A attribute, Alt-A loan pools include loans classified as "subprime." *Id.* at 3. The usual subprime borrower has either been delinquent on housing payments at least annually, or has a FICO score lower than 620. *Id.*

41 RETOOLING HUD, *supra* note 7, at 20.

42 *Id.*

43 Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp., 654 F. Supp. 2d 192 (S.D.N.Y. 2009), *appeal dismissed*, 603 F.3d 23 (2d Cir. 2010).

44 RETOOLING HUD, *supra* note 7, at 20.

Because the securitization transactions in the PLS home mortgage context are complex, some explanation is necessary for a basic understanding. If a financial institution owns a group of mortgages, which it either entered into itself or bought from another institution, it can sell them to a trust.[45] The trust issues bonds to pay for the mortgages, called mortgage-backed securities (hereinafter "MBS"), and these bonds are backed by the loans now owned by the trust.[46] The trust holds the loans, placing them far from the original institution's creditors, and a third-party loan servicer manages the loans for "the benefit of the MBS holders."[47] The servicer, usually a corporate subsidiary of the mortgage originator, collects payments from homeowners, handles paperwork, sells properties in the event of foreclosure, and entertains mortgage modification requests.[48] The contract between the servicer and the trust is called a pooling and servicing agreement and usually includes limits on modifying mortgages that are in or near default.[49]

II. BACKGROUND OF HOME MORTGAGE-RELATED LEGISLATION

A. The Truth in Lending Act

Enacted in 1968, the purpose of the TILA is to promote the "informed use of credit" by consumers.[50] The statute is intended to provide consumers with "a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him."[51] The 1967 Committee Reports explained that requiring creditors to consistently and uniformly disclose credit information, by requiring the inclusion of all mandatory charges in the

[45] *Helping Families Save Their Homes in Bankruptcy Act of 2009: Hearing on H.R. 200 and H.R. 225 Before the H. Comm. on the Judiciary*, 111th Cong. 46 (2009) (written testimony of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_house_hearings&docid=f:46615.pdf.

[46] *Id.*

[47] *Id.* at 46-47.

[48] *Id.* at 47.

[49] *Id.*

[50] 15 U.S.C. § 1601 (2010).

[51] *Id.*

calculation of the percentage rate, would give consumers the information needed to make an informed decision on using and comparing credit rates and costs.[52] Thus, the original focus of TILA was on the cost of credit.

William T. Cahill, a Republican congressman from New Jersey (and former New Jersey Governor) proposed the home mortgage amendments to TILA, which were included in the bill without further debate.[53] These amendments were primarily intended to prevent homeowners from being victims of "vicious secondary mortgage schemes."[54] Representative Cahill explained that "in many cases [a homeowner entering into a consumer credit transaction] is never informed nor aware that his home is being made subject to a mortgage."[55] The amendments, accepted by the Senate and adopted in the final version of TILA, require creditors to disclose that they are holding a security interest in the debtor's home.[56] The amendments set forth a three-pronged approach to regulate the secondary mortgage market. First, they "require a 3-day waiting period before a second mortgage transaction can be completed."[57] Second, they require disclosure that the credit is secured by a mortgage on the residence.[58] Lastly, the amendments enlarge consumers' legal rights when purchasing mortgages from an original home improvement contractor.[59]

B. The Helping Families Save Their Homes Act

The Homes Act was signed into law by President Barack Obama on May 20, 2009.[60] Two major elements comprise this Act. First, it amends the Housing Act of 1949 to require mortgagees, upon either actual or imminent default of a guaranteed mortgage, to participate in

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52 H.R. REP. NO. 90-1040, at 13 (1967); S. REP. NO. 90-392, at 3 (1967).

53 Anderson Bros. Ford v. Valencia, 452 U.S. 205, 220 (1981).

54 114 CONG. REC. 1611 (1968) (statement of Rep, Cahill).

55 *Id.*

56 *Anderson Bros. Ford*, 452 U.S. at 221-22.

57 114 CONG. REC. 5024 (1968).

58 *Id.*

59 *Id.*

60 Press Release, The White House Office of the Press Secretary, Reforms for American Homeowners and Consumers (May 20, 2009), *available at* http://www.whitehouse.gov/the_press_office/reforms-for-american-homeowners-and-consumers-president-obama-signs-the-helping-families-save-their-homes-act-and-the-fraud-enforcement-and-recovery-act.

loss mitigation instead of foreclosure.[61] The Act also permits the HUD Secretary to: (a) "authorize the modification of mortgages;" and (b) establish a program for payment of a partial claim to a mortgagee who agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence.[62] The Act also allows the Secretary to: (a) "authorize compensation to the mortgagee for lost income on monthly mortgage payments due to interest rate reduction;" (b) reimburse the mortgagee from a guaranty fund in connection with "activities that the mortgagee is required to undertake concerning repayment by the mortgagor of the amount owed" to HUD; (c) "authorize payments to the mortgagee on behalf of the borrower," under terms defined by HUD; and (d) authorize mortgage modification "with terms extended up to 40 years. . ." from the modification date.[63] Lastly, the Act also imparts the Secretary with the authority to assign to HUD a guaranteed mortgage on a family residence presently defaulting or facing imminent default, and prescribes procedures for HUD for payment of guarantee, disposition, and loan servicing.[64]

The second element of the Homes Act is its four major changes to TILA. First, the Act alters the TILA fiduciary duty requirements for servicers of pooled residential mortgages. Under the Act, any residential mortgage servicer that enters into "qualified loss mitigation plans" for mortgages that originated before the date of enactment of the Homes Act (including securitized or "bundled" mortgages), must honor these new fiduciary duty obligations that result as a matter of entering into a mortgage modification plan.[65] Second, the Act protects servicers from any liability if the servicer is determined to be acting in the best interests of all other investors and parties, and indicates that such servicers will not be subject to equitable liability based solely upon the execution of a "qualified loss mitigation plan."[66] Third, the Act states that any person, including a trustee, issuer, or loan originator, will not be liable for money damages or be subject to any equitable relief, based solely upon that person's cooperation with a servicer in implementing

[61] Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, 123 Stat. 1632.
[62] *Id.* at § 101.
[63] *Id.*
[64] *Id.*
[65] *Id.* at § 129.
[66] *Id.*

such a plan.[67] Lastly, the Act imposes liability upon a servicer (including a trustee, issuer, or loan originator) for actual fraud in the origination or servicing of a loan, in the implementation of a "qualified loss mitigation plan," or for violating any state or federal predatory lending law that regulates home mortgages.[68] Typical predatory lending practices include deceitful loan agreements, fraud, influencing borrowers through deceptive sales presentations, and abusing consumers' lack of understanding of contract terms.[69] The actors involved in predatory lending schemes can include mortgage brokers, bankers, realtors, appraisers, home improvement contractors, and any others directly or indirectly involved in the lending process.[70]

III. PAST ATTEMPTS AT HOME MORTGAGE REFORM AND WHY THEY FAILED

A. Hope Now

Hope Now is "an alliance between counselors, mortgage companies, investors, and other mortgage market participants," whose mission is to organize "outreach efforts to help homeowners in distress to help them stay in their homes, and. . .create a unified, coordinated plan to reach and help as many homeowners as possible."[71] The program began in October 2007, in the face of the mortgage crisis, through a joint effort between the Treasury Department and HUD.[72] Essentially, Hope Now is an unfunded government-organized network of industry participants who assist delinquent, or soon to be delinquent, borrowers in modifying the terms of their mortgage, or setting up alternative payment plans.[73] However, Hope Now's Executive Director, Faith

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67 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, §129 123 Stat. 1632, 1639.

68 *Id.*

69 Agpar, *supra* note 17, at 101 n.1.

70 *Id.*

71 *Are You Eligible?*, HOPE NOW, http://www.hopenow.com/hopenow-aboutus.php (last visited Oct. 25, 2010).

72 Press Release, Hope Now, Hope Now Alliance Created to Help Distressed Homeowners (Oct. 10, 2007), *available at* http://www.fsround.org/media/pdfs/AllianceRelease.pdf.

73 SHILLER, *supra* note 21, at 112; Henry M. Paulson, Jr., Treasury Sec'y, U.S. Dep't of the Treasury, Remarks before the New York Society of Securities Analysts (Jan. 7, 2008), *available at* http://www.treasury.gov/press/releases/hp757.htm.

Schwartz, was also an executive at Option One Mortgage — a subprime lender — at the time of her appointment to Hope Now.[74] Many industry participants in the program oppose such government intervention, which would modify mortgages and create losses for their companies.[75]

Irrespective of the shaky foundations of Hope Now, it has never provided relief to distressed homeowners. The program claimed to have helped 2.7 million borrowers as of October 2008, including 1.6 million homeowners with subprime loans; however, less than 20% of those mortgage modifications actually resulted in a lower monthly payment.[76] In the face of a serious mortgage crisis, a telephone hotline to credit counselors — funded by private banks or mortgage companies — was a weak effort to provide assistance to homeowners; it is generally considered a failed program.

B. Hope for Homeowners Program

Hope for Homeowners was established by Congress in July 2008, authorizing the Federal Housing Administration (hereinafter "FHA") to insure refinanced distressed mortgages.[77] It was intended to help approximately 400,000 homeowners with problematic mortgages, but as of February 2009, only twenty-five of 451 loan applications have successfully closed.[78] Mortgage servicers screen borrowers for the program after they qualify for a trial mortgage modification.[79] If borrowers qualify, they can then refinance their mortgage into a new loan through the FHA, while the mortgage investors take a write-down

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[74] *Option One Executive Faith Schwartz Named to Federal Reserve Board's Consumer Advisory Council*, BUSINESS WIRE, Jan. 24, 2006, http://www.allbusiness.com/banking-finance/banking-lending-credit-services/5388745-1.html.

[75] Lynnley Browning, *Distressed Owners Are Frustrated by Aid Group*, N.Y. TIMES, Apr. 2, 2008, *available at* http://www.nytimes.com/2008/04/02/business/02hope.html.

[76] *Helping Families Save Their Homes in Bankruptcy Act of 2009*, *supra* note 45, at 44; SONIA GARRISON ET AL., CTR. FOR RESPONSIBLE LENDING, CONTINUED DECAY AND SHAKY REPAIRS: THE STATE OF SUBPRIME LOANS TODAY 7-8 (2009).

[77] Hope for Homeowners Act of 2008, 12 U.S.C. § 1709 (2009).

[78] Brian Naylor, *Homeowners Rescue Program Shows Slim Benefits*, NPR (Feb. 3, 2009), http://www.npr.org/templates/story/story.php?storyId=100163398. As of September 2009, Hope for Homeowners has only helped ninety-five borrowers move into government-backed mortgages. Jessica Holzer, *Talks Stall on Mortgage Program*, WALL ST. J., Sep. 23, 2009, http://online.wsj.com/article/SB125373881952135221.html.

[79] Tara Siegel Bernard, *Slow Start to U.S. Plan for Modifying Mortgages*, N.Y. TIMES, May 13, 2009, at B1.

loss on their investment, and the government insures the new loan.[80] The main pitfall of the Hope for Homeowners program is that it requires banks or other investors in mortgages to take a loss by writing down the mortgage so that the borrower can receive a new government-backed mortgage. Thus, there is no real benefit to a mortgage holder for offering assistance to the financially strapped homeowner. As a consequence, it has shown little progress in reducing foreclosures.

C. FHA Secure Program

The FHA Secure program, starting in August 2007, offered refinancing for homeowners with non-FHA adjustable rate mortgages, including those with negative equity, into FHA fixed-rate mortgages, and was predicted to help approximately 240,000 homeowners.[81] However, the program helped only a few thousand delinquent borrowers refinance before being terminated at the end of 2008.[82] Senator Christopher Dodd, Chairman of the Senate Banking Committee, explained that "while a good idea, [the program was] not addressing the magnitude of the problem" because it failed to help those homeowners with serious threats of impending foreclosure, instead helping those borrowers who made their payments on time but requested government help before encountering more serious financial difficulties.[83] The program ended in December 2008 because of the negative impact on the FHA's Mutual Mortgage Insurance Fund; a letter to current borrowers explained that maintaining the program would have required loan premium increases or a total discontinuation of the FHA's Single-Family Insurance Program.[84]

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80 *Id.*

81 Press Release, Dep't of Hous. & Urban Dev., Bush Administration to Help Nearly One-Quarter of a Million Homeowners Refinance, Keep Their Homes (Aug. 31, 2007), *available at* http://www.hud.gov/news/release.cfm?content=pr07-123.cfm.

82 Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J., Dec. 31, 2008, at C1.

83 Rachel L. Swarns, *Federal Mortgage Plan Falls Short, Critics Say*, N.Y. TIMES, Apr. 30, 2008, *available at* http://www.nytimes.com/2008/04/30/business/30fha.html.

84 Letter from Brian D. Montgomery, Assistant Sec'y for Hous., Fed. Hous. Comm'r, to All Approved Mortgagees (Dec. 19, 2008) (on file with author).

IV. THE HOMES ACT OF 2009: EFFECTS ON OTHER PROGRAMS, LEGISLATION AND NEW INITIATIVES

A. Amendments to Hope for Homeowners

The Homes Act amended Hope for Homeowners to increase the affordability of mortgage modifications for borrowers. First, it permits reduction of the Hope for Homeowners up-front 3% fee to "up to 3%," and the exit fee may be reduced from 1.5% to "not more than 1.5%," thereby giving HUD the ability to lower the annual insurance premium fees on refinanced loans.[85] Second, the amendments provide financial incentives for mortgage servicers to utilize refinancing through Hope for Homeowners by permitting HUD to redistribute any property sale profits, up to 50% of the appreciation, to any senior mortgage holders.[86] Third, the Act makes Hope for Homeowners program requirements more consistent with standard FHA practices, thereby reducing the levels of confusing bureaucracy between the two entities.[87] As a result, all documents, forms and procedures for insuring mortgages under Hope for Homeowners are the same as those for mortgages insured by the regular FHA Single-Family Insurance Program.[88] Fourth, the Act moves administration of the program from the Board of Directors of the Program to the HUD Secretary, placing the Board in a more advisory role,[89] and providing the program with more resources and a dedicated staff within HUD. The Board consists of the Treasury Secretary, HUD Secretary, the Chairman of the Federal Reserve Board and the Chairman of the Federal Deposit Insurance Company.[90]

Although these amendments increase the affordability of refinancing through Hope for Homeowners, and create financial

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85 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 202, 123 Stat. 1632, 1642.

86 *Id.*

87 *Id.*; *Preserving Home Ownership: Progress Needed to Prevent Foreclosures: Hearing Before the Comm. on Banking, Hous., & Urban Affairs*, 111th Cong. 198-202 (2009) (prepared statement of Allen H. Jones, Default Management Policy Executive, Bank of America), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_senate_hearings&docid=f:55032.pdf.

88 Helping Families Save Their Homes Act of 2009 § 102.

89 *Id.*

90 Press Release, U.S. Dep't of Hous. & Urban Dev., Bush Administration Announces Flexibility for "Hope For Homeowners" Program (Nov. 19, 2008), *available at* http://www.hud.gov/news/release.cfm?content=pr08-178.cfm.

incentives for lenders to utilize this program, there are many critics who feel the changes do not go far enough to limit the number of foreclosures. One major issue is that the incentives are servicer-based rather than providing borrowers with direct financial assistance.[91] Those servicer incentives, usually an initial percentage of the loan and a future payment based on any appreciated property value, are not even considered incentives to mortgage industry insiders.[92] These percentage fees are considered to be too low to encourage active participation in Hope for Homeowners because the program requires a mortgage holder to fully release the borrower from indebtedness.[93] As a result, only those mortgages in serious risk of foreclosure are given over to the program since the mortgage holders have nothing else to lose.[94] The program also does not address homeowners who are currently unemployed and cannot make any payments,[95] a common situation that shows little potential for mortgage modification from servicers or investors.[96]

B. Amendments to TILA

The Homes Act also makes amendments to Section 129A of TILA, which was originally enacted by the Housing and Economic Recovery Act of 2008,[97] to provide residential mortgage servicers with a safe harbor from liability in connection with entering "qualified loss mitigation plans" with borrowers.[98] This safe harbor is extended to trustees, issuers, and loan originators when they cooperate with the servicer in the implementation of a qualified loss mitigation plan.[99] The

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91 Adam Weinstein, *Congress Mulls Radical Changes for Servicers, Lenders to Add Help for Homeowners*, DEFAULT SERVICING NEWS, Sept. 10, 2009, http://www.dsnews.com/articles/congress-mulls-radical-changes-for-servicers-lenders-to-add-help-homeowners-2009-09-10.

92 Letter from John A. Courson, President and CEO, Mortgage Bankers Ass'n, to Regulations Div., HUD (Mar. 9, 2009), *available at* http://www.mortgagebankers.org/files/AU/2009/MBACommentLetter_H4H_3-9-2009.pdf.

93 *Id.*

94 Jessica Holzer, *Talks Stall on Mortgage Program*, WALL ST. J., Sept. 23, 2009, http://online.wsj.com/article/SB125373881952135221.html.

95 Weinstein, *supra* note 91.

96 Steven Greenhouse, *65 and Up and Looking for Work*, N.Y. TIMES, Oct. 24, 2009, at B1.

97 Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654.

98 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, §201, 123 Stat. 1632, 1638.

99 *Id.* A "qualified loss mitigation plan" is defined in the Act as being either "a

amended Section 129A states that whenever a servicer of residential mortgages agrees to enter into a qualified loss mitigation plan with respect to one or more residential mortgages that originated before the date of enactment of the Homes Act, including mortgages held in securitization or other investment vehicles, the servicer's fiduciary duty to maximize the net present value of the mortgages will be "construed to apply to *all* such investors and parties, and not to any individual party or group of parties."[100] The servicer satisfies this duty if the servicer implements a qualified loss mitigation plan that meets the following criteria: (i) a default on payments has occurred, is imminent, or is reasonably foreseeable; (ii) a mortgagee occupies the property securing the mortgage as his or her principal residence; and (iii) the servicer reasonably determined that the application of a qualified loss mitigation plan will likely provide an anticipated recovery on the outstanding principal mortgage debt that would exceed recovery through foreclosure.[101] The safe harbor provision kicks in at this point, and a servicer deemed to be acting in the best interests of all parties will not be liable to any party based solely on the implementation of the qualified loss mitigation plan.[102] Furthermore, no person, including a trustee, issuer or loan originator, will be liable for money damages or be subject to an injunction based solely upon the cooperation of that person with servicer in order to implement the qualified loss mitigation plan.[103]

The Homes Act's second major amendment to TILA is the addition of a disclosure requirement.[104] Within thirty days after a mortgage is sold or transferred to a third party, the creditor (the new owner or assignee of the mortgage) must notify the borrower in writing of (a) the identity and contact information of the new creditor, (b) the date of transfer, (c) a way to reach the new creditor's agent, (d) the

refinancing of a mortgage under the Hope for Homeowners program" and/or "a residential loan modification, workout, or other loss mitigation plan, including to the extent that the Secretary of the Treasury determines appropriate, a loan sale, real property disposition, trial modification, pre-foreclosure sale, and deed in lieu of foreclosure, that is described or authorized in guidelines issued by the Secretary…under the Emergency Economic Stabilization Act of 2008; refinancing of a mortgage under the HOPE Program." *Id.*

100 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, §201, 123 Stat. 1632, 1638 (emphasis added).

101 *Id.*

102 *Id.*

103 *Id.*

104 *Id.* at § 404.

location where the transfer of mortgage ownership is recorded, and (e) any other relevant information regarding the new creditor.[105] Additionally, this amendment includes a provision giving borrowers a private right of action against the new creditor for non-compliance with this new disclosure requirement.[106] These remedies are in addition to attorney's fees for successful litigants, which were already available under TILA.[107]

These two amendments may encourage mortgage servicers to reduce foreclosures by providing a modification plan for borrowers. The safe harbor provision gives lenders that enter into qualified loss mitigation plans with borrowers an extra level of liability protection from both secondary investors in a securitized mortgage fund and the borrowers themselves.[108] The Act's definition for a qualified loss mitigation plan is quite broad as well, giving lenders a wide variety of options to help distressed homeowners.[109] In addition, element (ii), requiring that a borrower occupy the property securing the mortgage as his or her principal residence, ensures that only needy individuals, not those with several homes, are capable of receiving assistance from a mortgage servicer through this plan.

The new secondary mortgage market disclosure requirements mainly benefit consumers. Under this provision, borrowers must be provided with extensive contact details for secondary investors, enabling these borrowers to communicate their concerns more effectively in the event of late payments, foreclosure worries, or their family's changing financial situation. The threat of a private right of action by the consumer may also be a considerable tool for compliance against the secondary market investors.

From the borrower's perspective, there are no real downsides to these two TILA amendments. However, the amendments may generate

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105 *Id.*

106 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, §404, 123 Stat. 1632, 1658. Consumers are able to recover actual damages, as well as maximum statutory damages of $4000 in an individual action, or the lesser of $500,000 or 1% of a creditor's net worth in a class action. 15 U.S.C. § 1640(a) (2010).

107 15 U.S.C. § 1640(a)(3); Purtle v. Eldridge Auto Sales, Inc., 91 F.3d 797, 799-800 (6th Cir. 1996), *cert. denied*, 520 U.S. 1252 (1997).

108 Gretchen Morgenson, *A Reality Check on Mortgage Modification*, N.Y. TIMES, Apr. 25, 2009, at BU1.

109 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, §201 123 Stat. 1632, 1639.

problems for investors in securitized mortgage funds, because investors will only be able to assert claims against servicers who modify loans when an express contractual provision in the "pooling and servicing agreement" expressly prohibits loan modification.[110] Investors in funds without these agreements will be unable to impose liability on a servicer if that servicer chooses to enter into a qualified loss mitigation plan with a homeowner.

The other main problem with the new disclosure requirement is administrative in nature. New mortgage servicers are already required to send out servicing transfer statements under the federal Real Estate Settlement Procedures Act when they assign, sell or transfer a mortgage to another lender or servicer.[111] Still, the Homes Act's updated disclosure requirement introduces an extra level of transparency into the secondary mortgage market, and increases risks of litigation against primary and interim purchasers of loans. This litigation risk is most likely a signal from Congress to the secondary mortgage industry to acknowledge that their investments depend on a real person, the homeowner, and so they should work with the borrower to create a payment plan instead of choosing foreclosure.

V. COMPARISON WITH THE SAVE NEW JERSEY HOMES ACT OF 2008

Although the home mortgage crisis caused economic disruption across the United States, the home mortgage crisis deeply affected the State of New Jersey in particular.[112] In 2008, the rate of foreclosures in New Jersey rose from one in every 265 homes to one in every 201 homes.[113] On a national scale in 2008, the rate of foreclosure was one in every 171 homes.[114] In response to this growing concern in the State and throughout the nation, Governor Jon Corzine signed the Save New Jersey Homes Act of 2008 on September 15, 2008, and it remains in effect until January 1, 2011.[115] This statute is intended to protect only

110 Morgenson, *supra* note 108.

111 12 U.S.C.S. § 2605(a) (LexisNexis 2010).

112 Kareem Fahim & Janet Roberts, *In New Jersey, Dreams of a Better Life Dashed by Foreclosure Crisis*, N.Y. TIMES, May 17, 2009, at NJ1.

113 Beth Fitzgerald, *Foreclosure Rate Up 140% in the State, Dramatic Increase from April to June*, THE STAR-LEDGER, July 26, 2008, at 1.

114 *Id.*

115 Save New Jersey Homes Act of 2008, N.J. STAT. ANN. § 46:10B-40 (West 2008).

homeowners who signed introductory rate mortgages[116] that had low introductory "teaser rates," which bumped up to a higher rate later in the mortgage period and increased the risk of default or foreclosure.[117] The statute, meant to be construed liberally,[118] allows introductory rate mortgage borrowers to continue making monthly payments under the introductory rate for three additional years, beginning when the higher rate would take effect.[119] Like the federal Homes Act, the borrower must occupy the property as his or her principal residence,[120] so a person's vacation home in New Jersey is not eligible for introductory rate extension. When the lender begins seriously considering foreclosure on a property, it must alert the borrower in a large, bold-printed notice of these new rights under the statute.[121] This notice packet must include the actual form to receive a three-year extension and list any other alternatives to foreclosure, such as possible refinancing options.[122] This entire packet of information must be sent in a detailed envelope indicating its contents to the borrower.[123] The borrower must submit a certification of extension form back to the creditor, which includes:

> (1) the name of the borrower; (2) the address of the property; and (3) an affirmative statement that the eligible borrower: (a) does not have sufficient monthly income. . .to pay the monthly payments that will apply after the date that the interest rate resets; (b) requests the

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116 The New Jersey Legislature defined an introductory rate as such:

> (1) an introductory payment rate option that is set at least 3 percent below the fully indexed rate at the time the loan was originated and payments may adjust by more than 3 percent at the reset date regardless of whether the variable rate index has increased; or (2) an interest rate that may adjust by more than 2 percent at the end of the initial fixed rate period of the loan and which, notwithstanding the payment rate in effect, had an interest rate at origination of more than 200 basis points over the Freddie Mac 30-year conventional interest rate and which provides for an introductory rate that is set below the fully indexed rate at the time the loan was originated and may adjust at the reset date regardless of whether the variable rate index has increased.

Id. at § 46:10B-38.

117 ASSEMBLY FIN. INST. AND INS. COMM., FLOOR STATEMENT, Assemb. 2780, 2008 Sess., 212th Leg. (N.J. 2008), *available at* http://www.njleg.state.nj.us /2008/Bills/A3000/2780_S2.PDF.

118 N.J. STAT. ANN. § 46:10B-45.

119 *Id.* at § 46:10B-40(d).

120 *Id.* at § 46:10B-38.

121 N.J. STAT. ANN. § 46:10B-41(a)-(c) (West 2008).

122 *Id.*

123 *Id.* at § 46:10B-45.

> period of extension; (c) agrees to continue, during the period of extension, monthly payments, which shall include principal and interest calculated at the introductory rate. . .as well as amounts for taxes, insurance, and any other amounts being paid under the terms of the mortgage prior to the interest rate reset; (d) agrees to pay the creditor, at the time of the full repayment of the introductory rate mortgage, any interest deferred on account of the period of extension; (e) agrees to accept the creditor's. . .modification of mortgage on the property to secure the repayment of the interest deferred on account of the period of extension; and (f) agrees to sign a. . .form that contains the terms of the period of extension and any documentation necessary to establish or record the modification of mortgage.[124]

Any borrower who knowingly makes material misrepresentations in this certification is guilty of a fourth degree crime under this statute.[125] Similar to the federal Homes Act, the New Jersey statute also carries with it a private right of action for the borrower if a creditor "willfully violates any provision of [the] act."[126]

Although there are some comparisons with the federal Homes Act, the main difference is that the federal legislation in this area encourages loan servicers to make voluntary efforts to encourage mortgage modification, while the New Jersey law actually provides for mandatory mortgage modification by extending introductory rate periods beyond the original contract terms. The response by the mortgage industry to this sort of provision was the same refrain used in response to the threat of judicial modification through bankruptcy courts: increasing lending costs through higher interest rates or down payments to make up for legislatively-imposed losses.[127]

124 *Id*. at § 46:10B-40(b).
125 *Id.* at § 46:10B-40(c).
126 *Id.* at § 46:10B-43.
127 *Helping Families Save their Homes in Bankruptcy Act of 2009*, *supra* note 45, at 36 (testimony of Adam J. Levitin); Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J., Dec. 31, 2008, at C1.

VI. EFFECT OF THE HOMES ACT AND AVENUES FOR ADDITIONAL REFORM

A. Litigation Impact

In *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Financial Corp.*,[128] the District Court determined, *inter alia*, that jurisdiction surrounding the Homes Act's amendments to TILA is appropriately found in state, rather than federal, court.[129] The case involved a dispute between a putative class of plaintiffs, holders of mortgage-backed securities, and the defendant loan servicer, Countrywide.[130] After the housing market plummeted, Countrywide was charged with violating predatory lending laws in various states.[131] The settlement agreement included modifying approximately 400,000 loans, and providing over eight billion dollars in relief aid for homeowners serviced by the company.[132] The plaintiff investors' portfolio sustained considerable losses because of these incidental mortgage modifications, and plaintiffs alleged that Countrywide could only modify mortgages within the fund after it purchased the mortgages, thereby transferring the loss from the investment fund.[133]

Countrywide argued that federal jurisdiction was proper because (1) under the Class Action Fairness Act (hereinafter "CAFA") plaintiffs sought class action certification, the parties were minimally diverse, and the amount in controversy exceeded five million dollars;[134] and (2) because plaintiffs' claims introduced substantial federal questions.[135] The investors disagreed, countering that an exception to CAFA jurisdiction[136] applied, their allegations did not present federal questions,

[128] Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp., 654 F. Supp. 2d 192 (S.D.N.Y. 2009), *appeal dismissed*, 603 F.3d 23 (2d Cir. 2010). Initially the plaintiffs filed suit in New York State Supreme Court, and Countrywide removed to the Southern District of New York; the cited opinion concerns the plaintiffs' motion to remand back to state court. *Id.* at 194.

[129] *Id.* at 203-04.

[130] *Id.* at 193.

[131] *Id.*

[132] *Id.*; Vikas Bajaj, *Fund Investors Sue Countrywide Over Loan Modifications*, N.Y. TIMES, Dec. 2, 2008, at B8.

[133] *Countrywide*, 654 F. Supp. 2d at 194.

[134] 28 U.S.C. § 1332(d)(2)(A) (West 2005).

[135] 28 U.S.C. § 1331 (West 2005).

[136] 28 U.S.C. § 1332(d)(9)(C) ("[D]istrict courts shall [not] have original

and Countrywide's federal defense was insufficient to create subject matter jurisdiction.[137] Countrywide's defense raised the issue of the Homes Act's servicer safe harbor amendments,[138] discussed *infra*, and assuming that their mortgage modification settlement plan constituted a "qualified loss mitigation plan," then the statutory provisions create a federal presumption against liability when servicers modify loans.[139] Under the law, the plaintiff investors bear the burden of overcoming that presumption.[140] Countrywide argued that because it was the plaintiff's burden, "federal law [was] a necessary element of their claim and therefore a federal forum [was] required under Supreme Court precedent."[141]

The Court disagreed, explaining that plaintiffs' claims depended only on common law theories of contract interpretation, and Countrywide had the burden to show why TILA precluded the investors' claims.[142] Countrywide argued that TILA altered the state law of contract to require a specific rule of construction for pooling and servicing agreements.[143] However, the Court disagreed with Countrywide's interpretation of the TILA safe harbor provision.[144] It concluded instead that regardless of any state law changes, there was no evidence that TILA modified the common law cause of action for breach of contract.[145]

This case is one of the first that clearly demonstrates the potential ineffectiveness of the Homes Act. In this instance, it pitted investors in mortgage-backed securities against troubled homeowners, leaving the loan servicers in the middle armed with limited options.[146] Through the

jurisdiction…[over] any class action that solely involves a claim…that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security….").

137 *Countrywide*, 654 F. Supp. 2d at 195.

138 15 U.S.C. § 1639(a) (2009).

139 Brief of Defendant at 16, Greenwich Fin. Servs. Distressed Mort. Fund 3, LLC v. Countrywide Fin. Corp., 654 F. Supp. 2d 192 (S.D.N.Y. 2009) (No. 08 Civ. 11343).

140 *Id.* at 13-14.

141 *Id.* at 11-12 (citing Grable & Sons Metal Prods. v. Darue Eng'g & Mfg., 545 U.S. 308 (2005)).

142 *Countrywide*, 654 F. Supp. 2d at 202-03.

143 *Id.*

144 *Id.*

145 *Id*.

146 Gretchen Morgenson, *Countrywide Loses Ruling in Loan Suit*, N.Y. TIMES, Aug. 20,

Homes Act, Congress has charged mortgage servicers with keeping homeowners in their homes by offering monetary incentives, and has attempted to limit liability for cooperative servicers who engage in good-faith mortgage modification. At the same time, investors are losing out because some contracts contain provisions that prohibit such modification.[147] Granted, the opinion in *Countrywide* only remands the action to state court, at which point a judge may rule that the loan servicer's liability is ultimately shielded by the new safe harbor provision, but that is still an open question at this point. In response, there should be a clear move by servicing companies and mortgage-backed investor funds to remove impediments to loan modification. Such a move within the mortgage industry would surely benefit homeowners because servicers would no longer be threatened with lawsuits by their investors, and could therefore more willingly engage in mortgage modification procedures.

B. Bankruptcy Provisions Will Increase Opportunities for Mortgage Modification.

Although the Homes Act aims to help homeowners avoid foreclosure, its financial servicer incentives are at odds with pooling and servicing agreements between servicers and investors of mortgage-backed securities. These pooling and servicing agreements limit the ability of servicers to engage in mortgage modification, making it nearly impossible for servicers to operate within the current version of the Homes Act.[148] One significant proposal that did not make it to the final version of the statute granted authority to the U.S. Bankruptcy Courts to modify residential mortgage agreements.[149] Senator Durbin, the sponsor of this amendment, explained provision as follows:

> We literally give to the banks control over whether a family in foreclosure can go into bankruptcy. [A]nybody facing foreclosure - who is delinquent for at least 60 days on a home that is valued at no more than $729,000, with a mortgage that was written no later than 2008 - has to show up at the bank at least 45 days before they file

2009, at B1.

[147] *Id.*

[148] *Helping Families Save Their Homes in Bankruptcy Act of 2009*, *supra* note 45, at 38 (written testimony of Adam J. Levitin).

[149] 155 CONG. REC. S4915, 4917-4918 (daily ed. Apr. 30, 2009) (statement of Sen. Dick Durbin).

> bankruptcy and present all the economic information, all the financial documents the bank would need for a mortgage - proof of income, indication of net worth. If the bank. . .offers them a renegotiated mortgage - a mortgage which will basically allow them to stay in the home. . .or offers hope for home refinancing. . .and the person facing foreclosure does not take that offer, then that same family in foreclosure cannot use the bankruptcy court to rewrite the mortgage. So in other words, the banks ultimately have the key to the courthouse.[150]

Currently, federal bankruptcy judges are authorized "to modify debt on a vacation home, an investment property, a credit card, a car loan, even a yacht,"[151] but not a primary residence.[152] The policy behind the special protection for principal residences is that Congress believed, in 1978, that if lenders were shielded from taking a loss in bankruptcy, competition between lenders would result in transferring these gains to consumers in the form of lower loan costs, and would therefore encourage homeownership.[153] Unfortunately, this economic belief is misplaced, since bankruptcy modification risk is not calculated into residential mortgage pricing or mortgage insurance pricing, and there is no noticeable effect on U.S. homeownership rates.[154] In fact, bankruptcy is designed to give creditors at least as much as they might recover in foreclosure,[155] so there is little reason to suggest that the mortgage industry would price against judicial modification through the bankruptcy courts. If U.S. Bankruptcy Judges are ever granted this additional power, mortgage servicers and lenders may make stronger efforts to develop modification plans because of the potential for less favorable judicial modification.[156] Unfortunately, the Durbin amendments to the Bankruptcy Code were not passed, removing this great potential for reducing foreclosures through the judicial process.

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150 *Id.* at 4917.

151 *Id.* at 4919 (statement of Sen. Jeff Merkley).

152 11 U.S.C. §§ 1123(b)(5), 1322(b)(2) (2005); Stephen Labaton, *Ailing, Banks Still Field Strong Lobby at Capitol*, N.Y. TIMES, June 4, 2009, at A1.

153 155 CONG. REC. S4915, 4924 (daily ed. Apr. 30, 2009) (statement of Sen. Jon Kyl); Adam J. Levitin, *Helping Homeowners: Modification of Mortgages in Bankruptcy*, 3 H.L.P.R. ONLINE 1, 7 (2009). http://www.hlpronline.com/Levitin_HLPR_011909.pdf;

154 Levitin, *supra* note 153.

155 11 U.S.C. § 1325(a)(5) (2005).

156 RETOOLING HUD, *supra* note 7, at 17.

C. The Save New Jersey Homes Act Offers More Direct Route for Homeowners.

Compared to the Homes Act, which offers financial and liability-limiting incentives for mortgage servicers, the New Jersey Act actually gives direct relief to homeowners with introductory rate mortgages. The New Jersey legislation, discussed *supra*, allows homeowners to extend their introductory rate for three additional years, instead of having a higher monthly payment as a result of an adjustable rate.[157] Presumably, the New Jersey legislature believed that three years would be the appropriate amount of time for financially distressed homeowners to recover since the statute's sunset provision causes expiration on January 1, 2011.[158] If financial recovery takes longer, however, hopefully the legislature will renew the statute for a longer period. Like the Homes Act, the New Jersey statute also protects the homeowners most in need of government intervention and those targeted by such introductory rate mortgages, by only allowing the rate extension for a property that is occupied by the borrower as his principal residence.

Still, the New Jersey Act requires mortgage servicers involved with mortgage-backed security trusts to effectively break their contracts with those trusts. By engaging in mortgage modification at the behest of the State legislature, the income streams to investors are compromised, and the servicers may even be prohibited from modification by the pooling and servicing agreement. It will be interesting to see if New Jersey courts hear contract cases between servicers and investors, like *Countrywide*, and if they will decide whether the statute violates New Jersey common law contract principles. This is a potential weakness in the statute that could be remedied through the use of a bankruptcy amendment in the federal Homes Act, since there are no bankruptcy forums in the state courts.

D. Potential Policies That May Stem the Tide.

Consumers must make informed decisions when signing a mortgage, but in some low-income regions the resources of sophisticated financial advisors are unavailable. It is essential that all types of consumers be able to access helpful and accurate information

157 N.J. STAT. ANN. § 46:10B-40(a) (West 2008).

158 *Id.* at § 46:10B-36.

before entering into an expensive transaction. Three avenues for reform should be pursued: (1) expanding public interest legal and financial advising firms dedicated to providing low-income communities with sound financial advice; (2) creating a federal Commission for Financial Product Safety that would serve as a resource for information and create regulations to ensure safety of risky financial products; and (3) improving the standard mortgage contract to provide for default-option financial planning.

A major factor contributing to the subprime mortgage crisis was financial ignorance of many consumers, coupled with predatory lending practices. As discussed earlier, the biggest victims are often low-income neighborhoods comprised of minority groups.[159] While banks and mortgage brokers must change such discriminatory lending practices, local community institutions may be able to provide consumer financial education to residents. Universities, specifically law schools and business schools, should offer such services free of charge, and in conjunction with social justice or pro bono projects. Providing such information about the pros and cons of different types of loans, explained in a simple way, will arm low-income residents with the knowledge necessary to make an educated financial decision.

The second area of reform should be the creation of a dedicated financial products safety agency. The Federal Trade Commission's Bureau of Consumer Protection states that one of its goals is to "protect[] consumers from deceptive and unfair practices in the financial services industry, including protecting consumers from predatory or discriminatory lending practices, as well as deceptive or unfair loan servicing, debt collection, and credit counseling or other debt assistance practices,"[160] however, the Federal Trade Commission is already stretched thin, which is why there is a need to develop a separate agency. This regulatory agency would research new financial products to discover their short- and long-term effects, levels of risk, and tax consequences, and pass any regulations necessary to ensure consumers' safety in purchasing such a product. As of the date of this Note, financial institutions still engage in risky practices, and most

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159 *See supra* note 20.

160 *About the Bureau of Consumer Protection*, FED. TRADE COMMISSION, http://www.ftc.gov/bcp/about.shtm (last visited Oct. 25, 2010).

proposed regulations have generally been stalled in Congress.[161] Until forceful consumer financial product safety regulations are passed, many homeowners will still be at grave risk of purchasing subprime, inferior mortgages.

Lastly, the mortgage industry should make improvements to the standard mortgage contract and create other coordinated policies that discourage foreclosures. The federal government, as part owner of several failing financial institutions and the Fannie Mae/Freddie Mac mortgages, should help direct the course to decreasing the national mortgage debt.[162] These policies should include a moratorium on foreclosures, allowing current foreclosed property to sell and equalize the market. Also, there should be standardized policies for mortgage modifications, the possibility for reducing principal debt, or allowing the Treasury Department to buy out some delinquent mortgages at a discount price, thereby shifting losses from private investors to the taxpayers.[163]

A true solution to the foreclosure crisis must include all types of initiatives that can help reduce the national mortgage debt. Private industry efforts, or simply waiting for a more organic housing market recovery, will prove to be just as fruitless as it has been since the end of 2007. Families across the country suffering through this crisis, even those few that are given the chance to modify their mortgage terms, need effective reform. The federal government and mortgage industry must come up with viable solutions to help the nation get itself out of this costly crisis.

CONCLUSION

The Homes Act, as it stands, does not do enough to provide direct assistance to frustrated homeowners facing a slow economic recovery. And while banks or investors might balk at taking financial losses by modifying mortgages, some consumers are starting to realize they have another option: the voluntary default. Homeowners might choose to voluntarily default on their mortgage if their mortgage debt outweighs

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[161] Alex Berenson, *A Year Later, Little Change on Wall St.*, N.Y. TIMES, Sept. 11, 2009, at A1.

[162] Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications*, 41 CONN. L. REV. 1107, 1129 (2009).

[163] *Id.* at 1130.

the worth of their house.[164] Companies like 'You Walk Away' advertise "strategic" default plans, which include consultations with real estate attorneys, advice on how to avoid harassment by creditors, and education about the effects on a credit score.[165] Mortgage modification plans may work for many people, especially those with jobs, but many who are unemployed are simply extending the period until inevitable foreclosure. If the long-term sustainability of a mortgage payment is unlikely, then even a lower payment may not be in the best financial interest of an individual or family. An onslaught of voluntary defaults might even produce beneficial economic results. There might be an even greater incentive to make effective home mortgage modifications if a wave of voluntary foreclosures strikes fear into the hearts of banking institutions.[166]

Bankruptcy provisions would effectively produce a similar result of encouraging meaningful mortgage modification plans for homeowners. The potential for more significant losses through judicial modification would likely encourage mortgage servicers and lenders to make greater strides in developing modification plans for distressed homeowners. In a world of judicially imposed mortgage modification, however, there could be the potential for including the cost of bankruptcy modification into future mortgage lending. Such increased lending costs might not be a bad thing, and may likely have the effect of home mortgage lending only to those who can truly afford it.

[164] Eric Weiner, *Why Not Just Walk Away from a Home?*, NPR (Feb. 13, 2008), http://www.npr.org/templates/story/story.php?storyId=18958049.

[165] YOU WALK AWAY, http://www.youwalkaway.com (last visited Oct. 25, 2010).

[166] Roger Lowenstein, *Walk Away From Your Mortgage!*, N.Y. TIMES, Jan. 10, 2010, at MM15.