Home Sweet Home

A Cambridge Credit Counseling Corp. Call to Action to Resolve the Foreclosure Crisis

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In the summer of 2008, as Wall Street investment firms collapsed and the stock market began a roller-coaster ride that continues to this day, Americans finally began to appreciate the scope of the growing financial crisis. The public was initially shocked at the severity of the situation, but for many, that shock turned to disgust at the end of September, when Congress hastily cobbled together a Wall Street bailout plan with the potential to cost taxpayers 700 billion dollars. Though it failed to pass on its initial vote, a second version of the bill was passed easily on its second opportunity. As aspects of the law are unveiled, the public will become aware of the various provisions and powers now available to stave off recession and help stabilize their financial lives. While much will be done to free frozen credit markets, it is still unclear as to how the legislation will address a growing issue that more and more Americans are struggling with – foreclosures.

Christopher Viale, president and CEO of Cambridge Credit Counseling Corp., an agency that hears from thousands of financially distressed consumers every month, is one of many who believe that a comprehensive and focused approach must be taken to get the American economy back on track. First, however, a conversation must be held to determine what solutions are feasible, which will do the most good, and how quickly we can reasonably act to save homeowners. *The purpose of this piece, therefore, is merely to begin that discussion, to put forth some proposals that seem appropriate from Cambridge's perspective, and to encourage others to share their expertise in hopes of creating the most effective and appropriate remedies possible.*

Why We Must Act

Many Americans who have voiced their opposition to the rescue plan are against bailing out those who acted recklessly in extending mortgages to people who couldn't afford them, against bailing out those consumers who knew that the loans they were securing were beyond their means to repay, and against bailing out bankers and investors who traded in mortgage backed securities they should have known to be unreasonably risky. These arguments certainly have merit, but there are a number of other factors that make intervention a necessity, and, because the bill has become law, listing all of the reasons cited by its proponents isn't necessary here. We would like to point out a few, however, that we didn't hear in the course of post-vote interviews.

Beyond the most obvious outcomes of foreclosure - the need for some sort of immediate replacement housing, the cost to banks (reportedly $50,000 per home), the significant damage to the homeowner's credit, and the lowering of property values, there are serious social and workplace implications that cannot be ignored. For example, financial stability is essential to the physical and emotional health of most adults. In times of personal economic hardship, people often experience illness and depression. They are incapable of performing to their full potential at work, resulting in an alarming loss of productivity. A Yale University study indicated that those who suffer from depression, a symptom of financial distress, are *seven times less productive* than their stress-free peers. Apart from everything else, America cannot afford to lose productivity at a time when the economy is already faltering.

At home, the toll that financial problems take can be even more devastating, since money troubles often lead to the dissolution of marriages and the destruction of families. Those affected by looming financial concerns feel alienated and often experience desperation that can, unfortunately, lead to dangerous consequences. America has been introduced to the severity of these consequences through recent media stories that recount tales of individuals inflicting mortal harm to themselves, and family members. While these occurrences are rare, there are additional concerns regarding the strain American families currently feel. An estimated 2,000,000 children have already been affected by foreclosures since the mortgage crisis began. In addition to the obvious loss of innocence, many of those children will suffer long-term complications, depending upon the circumstances and duration of their displacement. Homeless shelters across the country, including the network to which Cambridge provides counseling services, are currently reporting dramatic increases in the numbers of families seeking refuge, and the strain on already under-funded social service agencies will only increase if nothing is done to stem the tide of foreclosures. The solution is simple - the government must take immediate action directly on behalf of residential homeowners.

Who Should Be Helped

Over the last two years, America has seen unprecedented foreclosure rates (currently about 20,000 per week, nationwide), and most financial experts expect that the number could increase by an additional 15 to 20% per week as new waves of adjustable rate mortgages (ARM's) begin to reset this month. Those are startling figures by any measure, and most existing rescue efforts are targeted at the consumers who comprise a significant portion of this unfortunate group, specifically, those homeowners who *could* afford a workout plan predicated on a modest reduction in the monthly payment. This approach is certainly appropriate, but it overlooks a portion of the population that we should also consider carefully: the number of consumers who are *barely able* to afford their current mortgage payments.

Such individuals make their mortgage payment every month, or in most months, but they also miss payments on other obligations with some frequency. They can afford very little beyond their home, but, if given the opportunity for mortgage relief, they would help revive our sagging economy as traditional consumers do, by participating more fully within the system. How many homeowners fit this description isn't known precisely, but in Cambridge's counseling experience, and given the negative national savings rate, the number is likely significant. Without such assistance, this group of homeowners stands at the brink of foreclosure, a minor medical emergency or home repair bill away from going over the edge. Cambridge feels that these individuals must also be considered in any conversation about solving the foreclosure problem.

A Practical Suggestion: *Home Sweet Home*

Congress's bailout plan gives the Secretary of the Treasury the authority to develop a plan to purchase mortgages from distressed homeowners, but it stops short of establishing specific processes and guidelines for the strategy to be implemented. We believe that the best solution would be for the government to purchase troubled mortgages at current market values and re-write them as 30-, 40- or 50-year fixed-rate loans, as appropriate to the homeowner's circumstances. While this will result in increased costs to consumers over the lifetime of the loan, many homeowners would certainly be willing to pay more in the long-term in exchange for financial stability today.

The lending industry has already witnessed the consumer's willingness to accept higher overall costs in exchange for lower monthly payments, ironically enough through the wide popularity of both ARM and hybrid products. The benefit of restructuring through this initiative is that government loans would require the lower monthly payment to be locked in – allowing for predictable budgets over the term of the loan. In addition, crystal clear disclosures, an uncommon occurrence in today's lending climate, would detail the terms of the restructured loan in easily understandable language. Most important, millions of Americans would be able to remain in their homes and resume their place in the economic system as productive consumers.

A Premium on the Restructured Loan

In a typical mortgage reset, the payments made by a consumer to satisfy the obligation increase according to a pre-determined schedule. Let's assume that a consumer has made payments for 5 years and have $200,000 remaining on their ARM as they reach their re-set. Their monthly payment at 6.25% over the remaining 25 years would be $1,319, and they'd pay a total of $395,000 over that span. By converting the remainder of the ARM to a 50-year term, the consumer's monthly obligation would be reduced to $790, a savings of $529 per month.

Because the lower monthly payment represents a loss for the lender, a mechanism must be put in place to entice both the lender and the government to restructure such troubled loans. The *Home Sweet Home* initiative calls for an additional premium to be placed on restructured products. As a result of extending the loan, for example, the consumer's total repayment would be increased by 20% over the new schedule. As opposed to repaying $395,000 on the initial mortgage, the consumer would now repay $475,000 – a profit to lenders and/or investors of $80,000. (The increased consumer burden would also be offset somewhat by the prospect of tax write-offs for mortgage interest.) Restructuring the loan in this manner would result in a final interest rate of 4.1%, as shown in the following table of benefits.

Loan Term	Loan Repayment	Monthly Payment	Homeowner
30 Years (Adjustable)	$395,000	$1,319	Constant risk of foreclosure Unproductive consumer
50 Years (Fixed)	$475,000	$790	Budget stabilized Productive consumer
Additional 20 Years	$80,000 profit to investors	$529 savings monthly for consumer	Homeowner retains home. Bank saves foreclosure costs. Loan becomes valued asset.

Eligibility

The guidelines for participation in a restructured loan program should account for a number of factors, and we would be open to a discussion of appropriate criteria with industry professionals. At the very least, these should include a consideration of the current market value of the home, verification of the homeowner's actual income and ability to afford the proposed payment, as well as any equity that may currently exist. We would also suggest that a financial literacy component be included, to be coordinated and delivered through any of the nation's certified credit counselors or through interactive curricula residing on the Internet. Such a requirement would improve the homeowner's understanding of the fundamental principles of credit, budgeting and saving, while improving their chances of maintaining homeownership.

The inability to save, in particular, has forced many consumers to rely on credit, a dependency that helped bring us to our current state of affairs. An estimated 71% of Americans live from paycheck to paycheck, relying upon credit for the basic necessities. Incorporating a financial literacy component in the *Home Sweet Home* initiative will empower individuals to take command of their financial lives. Homeowners could begin to build substantial savings and learn to spend their money wisely, ultimately helping rehabilitate the economy.

The Benefits of the Home Sweet Home Plan

The conversion of troubled loans to fixed-rate mortgages would have far-reaching benefits throughout the economy.

- In the short-term, homeowners would gain the financial relief they desperately need, while in the long-term, restructured loans would help stabilize markets as these formerly toxic assets performed successfully.

- The significant monthly savings to homeowners would allow for an infusion of cash into the economy, as consumer spending would undoubtedly increase.
- Banks would avoid significant foreclosure costs, and avoid having a backlog of homes to sell.
- The restoration of real value to suspect or worthless loans would help to free up the credit market and inspire consumer and investor confidence.

State and Local Benefits

States and local municipalities are facing deficits due to reductions in tax revenue due to unproductive consumer behavior. In Connecticut and Massachusetts, for example, governors are already considering drastic measures to offset reductions in revenues derived from sales taxes. Many cities and towns are beginning to face similar reductions in tax revenues due to the property devaluation resulting from home foreclosures. The benefit of stabilizing the American homeowner through the *Home Sweet Home* initiative would be realized almost immediately on a state and local level. Confident consumers maintain disposable income, which in turn, is spent throughout local economies.

Similar Efforts

We recognize that this is a rapidly changing arena, and that a number of programs are either in development or rolling out as we speak. We applaud Bank of America's decision this week to extend re-write options to as many as 400,000 former Countrywide customers, though we recognize the limitations on eligibility for participation. Similarly, the government's IndyMac program is a positive step, and we hope that those who qualify for it are able to take advantage of the offer as quickly as possible. Two nights ago, Senator McCain stated that he would instruct Secretary Paulson to buy troubled mortgages at face value and convert them to fixed-rate loans, a costly variation on this proposal but still worthy of consideration. The sheer number of rescue plans that may ultimately be offered is probably a reflection of the fact that almost 80% of those homeowners holding a sub-prime mortgage do not qualify for the services currently in place to help them. We applaud each of these programs, despite their limitations, but we believe that a comprehensive government solution is also in order.

The bailout law allows Secretary Paulson wide latitude to design the government's rescue plan, and in his speech yesterday he urged patience while that program is developed. It is therefore vital for those with any expertise in this area to take advantage of this brief window of opportunity to share their ideas, as we have done today. We invite legislators, lenders and consumer advocates to discuss the finer points of the *Home Sweet Home* initiative and to give us feedback that might improve our proposal.

Sincerely,

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