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MORTGAGE MODIFICATIONS DURING THE FORECLOSURE CRISIS

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BEFORE THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

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MORTGAGE MODIFICATIONS DURING THE FORECLOSURE CRISIS

THURSDAY, AUGUST 20, 2009

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC

The Committee met, Pursuant to notice, at 10 a.m., U.S. Senate, Committee on the Judiciary, Rhode Island Housing, Providence, Rhode Island, Hon. Sheldon Whitehouse presiding.

OPENING STATEMENT OF HON. SHELDON WHITEHOUSE, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator WHITEHOUSE. Well, good morning everyone. This is an official field hearing of the U.S. Senate Subcommittee on Administrative Oversight and the Courts of the Senate Judiciary Committee.

I want to open by thanking Susan and everybody else at Rhode Island Housing for hosting us here this morning.

Nearly 10 months ago, we enacted a $700 billion bailout package to rescue the economy from the subprime mortgage meltdown. This hearing will look at whether the foreclosure situation is worsening in Rhode Island and what can be done for the millions of families in our state and across the Nation who are at risk of losing their homes.

We tried in October to include in the troubled asset relief program measures that would help homeowners on Main Street, in addition to the banks on Wall Street. Unfortunately, these efforts proved fruitless.

As you recall, we included in the bailout legislation a requirement that the Treasury work to modify the mortgages it purchased as part of the TARP, but then the administration decided not to purchase toxic assets as they had initially proposed. The money instead went directly to banks, and since the Treasury held no mortgage-related assets to modify, Wall Street won and Main Street lost.

Democrats in Congress led by Senator Durbin of Illinois tried unsuccessfully to include in the TARP legislation a provision that could have kept millions of families in their homes at zero cost to taxpayers. This proposal would have corrected an anomaly in the bankruptcy code that prohibits judges from modifying primary residents' mortgages, the way they can modify every other type of contract from mortgages to vacation homes to car and jewelry and corporate loans. Even though bankruptcy modification would spare the community, the terrible cost of foreclosure, the mortgage bank-

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ing industry invented hundreds of millions of dollars to lobby against its reform and has so far been able to prevent its passage.

As subprime mortgage teaser periods began to expire last year, and with the credit market dried up so folks could not refinance, millions of homeowners faced higher monthly payments that they could not afford.

In the final quarter of 2008, there were over 200,000 residential foreclosures. These homeowners faced this foreclosure wave with minimal assistance from their government.

The new administration has tried to address the foreclosure crisis. Through the Treasury's Making Home Affordable programs, President Obama encouraged loan services to start modifying mortgages. While these programs so far have kept 230,000 families in their homes through trial modifications, it is becoming increasingly clear that Congress must do more to address what is a worsening crisis.

As you will hear from one of the witnesses today, there is evidence that the worst of the foreclosure crises is not behind us. Just as the wave of foreclosures from subprime mortgages begins to subside, a new wave of potential foreclosures tied to rate resets on other mortgage instruments is lurking just around the corner.

The Center for Responsible Lending estimates 9 million families may lose their homes to foreclosure from 2009, this year, through 2012. At their current rates, the Treasury's voluntary programs will only assist 2 million or fewer families during that period.

It is clear to me that Congress must do more to help struggling homeowners and specifically that we need to take another serious look at the Durbin proposal to allow bankruptcy judges to modify the terms of mortgages on principal residences the way they can on every other loan.

If we fail to break the vicious cycle of foreclosures, falling home values and declining tax revenues, we may end up mired in recession for years to come.

Before concluding my opening remarks, I want to acknowledge the hard work of my senior senator, Jack Reed in preserving and creating affordable housing in Rhode Island and across the country. It is a privilege for me as a new senator to work alongside such a champion of accessible housing and fair mortgage practices.

I look forward to hearing the views of today's panel on this proposal and others. Joseph Verdelotti, Jr. of West Warwick will share his experience struggling with two mortgages during a period of rising costs and falling home prices.

Mr. Verdelotti, a licensed electrician, and his wife April, a hospital worker, have been unable to obtain mortgage modifications and may soon be forced to leave their home. I would add that he gave extremely powerful testimony in Washington recently and we are privileged to have him come down to Washington to share his views.

Jeffrey Burlingame and his wife Rachel purchased their home in Woonsocket in 2006 and have also struggled to keep up with payments. Mr. Burlingame, a firefighter, will discuss his difficulties in obtaining more reasonable mortgage terms from his loan servicer. I can't see Jeffrey without thinking of his mother, Barbara, who was a great leader in the state and a great friend to many of us.

David Pollock of Cranston is a homeowner who also invests in rental properties. Mr. Pollock has a Bachelors Degree in Business Administration from the University of Massachusetts at Amherst and an MBA from Boston University. Mr. Pollock has already received a foreclosure notice on his residence and is working hard to save it.

Susan Bodington is Deputy Director for Programs at Rhode Island Housing. Ms. Bodington joined Rhode Island Housing in 1991 and has served as Director of Housing Policy. She holds a BA in Economics from Smith College.

Finally, John Rao of Newport is an attorney with the National Consumer Law Center in Boston who focuses on consumer credit and bankruptcy issues. The National Consumer Law Center performs research and trains attorneys who serve low income consumers.

Mr. Rao was appointed by Chief Justice Roberts to serve on the Federal Judicial Conference Advisory Committee on Bankruptcy Rules. Mr. Rao earned his degrees from Boston University and the University of California Hastings College of Law.

So without further ado, why don't we begin with Mr. Verdelotti, and why don't you proceed. Thank you very much again for being here and sharing your experience with us.

STATEMENT OF JOSEPH VERDELOTTI, LICENSED ELECTRICIAN, WEST WARWICK, RHODE ISLAND

Mr. VERDELOTTI. Chairman Whitehouse, thank you for the opportunity to testify here today. This is the second time this summer that you have invited me to tell my story before the Senate Judiciary Committee. I am grateful for your attention to my case.

My name is Joe Verdelotti, Jr., and I am a licensed electrician from West Warwick, Rhode Island. My wife, April, works at the Rajoines Medical Center in Providence, Rhode Island. We have been married for nine and a half years and have known each other for nearly 20 years.

We have one daughter, Brooke, who is nine and two sons. Lorenzo who is six, and Gianna just celebrated his first birthday a few months ago.

Needless to say, we have quite an active household. On January 26, 2006, we purchased an 1,100 square foot home in West Warwick, Rhode Island for $225,000. Since we like many other homeowners did not have savings for a down payment, we took out two mortgages. The first mortgage which covered 80 percent of the purchase price is an adjustable rate mortgage that is currently at 6.5 percent, but will adjust in the fifth year.

The second mortgage which covered the other 20 percent of the purchase price has a fixed interest of 9.25 percent. Both mortgages were originally through Aurora Loan Services, but Citimortgage subsequently purchased the second mortgage.

At the time we purchased our home, I was a fourth year electrician's apprentice making $18 an hour. The construction industry was booming and times were good in Rhode Island. The good times did not last, however. Not long after we purchased our home, the recession began and work became scarce.

My company has had to lay off workers and make cutbacks just to stay afloat. As of today, we still have a wage freeze in effect and hour health care premiums have increased.

In addition, we just learned that we will lose the Columbus Day holiday and will not be paid for days at the end of December unless we use our vacation time.

My wife too has felt the effects of the recession at work and is also under a pay freeze. Despite our income freeze, the cost of living has not slowed and we are feeling the squeeze.

Our utility bills such as electric and water have increased, as have our property taxes, and we may see further increases in the future. Our budget is stretched as tight as we can get it.

Like many of our neighbors, our home is under water. It is just not worth what we paid for it at the height of the housing bubble in 2006. We received a glimmer of hope last fall when the HUD for Homeowners Program took effect, but that proved to be a disappointment. The day the program started, my wife called the number listed on HUD's website and spent hours waiting and talking to someone at the debt service about our situation.

In the end, their only advice to her was to consider a roommate, get a part-time job, contacted the United Way to locate food banks in our area, reduce spending and contact Legal Aid for a consultation with a bankruptcy attorney. The person on the phone even recommended we consider walking away and letting the bank foreclose.

We called for help in saving our home and we were told to consider food banks and foreclosure.

I later contacted Aurora Loan Service directly and spoke with a customer service agent to see if they would be willing to work with us under the Help for Homeowners Program.

After giving the necessary information to the agent over the phone, I was met with another disappointment blow. The agent informed me that we did not make enough money for them to help us and that we should consider a short sale.

Next we decided to apply for a financial hardship package through Citimortgage. On February 26th, 2009 we sent Citimortgage the necessary documents through certified mail. The documents were received on March 2nd. On March 20th, my wife contacted Citimortgage at approximately 1 p.m. to try and find out the status of our hardship application. But all she got was the run around.

Each person she spoke to said she had the wrong department and that they would transfer her to the right one. But this never happened. This went on until I came home from work and I took over. Each person was clearly reading from the same talking points. We always had the wrong department and they would transfer us to the correct department.

After listening to elevator music on hold for over an hour, I too gave up. We had been on the phone with Citimortgage for over 5 hours and accomplished nothing.

On April 8, 2009, my wife contacted Citimortgage again and after several attempts to get a straight answer, she was informed that our case was closed since they never received our packet. She in-

formed them that it was sent on February 26th and that we had delivery confirmation that they received it on March 2nd.

After hearing this, they changed their story to it must have gotten lost and that we would need to resubmit the application. This was quite unsettling to hear, because the package contained all of our personal and financial information.

Since we have two mortgages, we also sent a hardship package to our first lien holder, Aurora Loan Service. In a letter dated March 11, 2009, just 2 days after receiving the package, Aurora denied our request.

In May I once again requested a mortgage modification from Citimortgage. This time we were rejected because according to them, we made sufficient income to support our current mortgage payment. They also suggested that we consider a short sale.

Citimortgage apparently believes that we make enough to cover our mortgage but that we should consider a short sale. This seems pretty contradictory to me.

Now, even though we are current on our financial obligations, we are hardly living comfortably. We have had to make even more adjustments in order to make ends meet, and it gets increasingly difficult.

We are not sure how much longer we can survive like this. My health care premiums rose at the same time the Make Work Pay tax credit took effect. So now I take home $2 less a week than I used to.

How can my family and others help stimulate the economy if Congress doesn't do something fast to help curb this foreclosure problem? All we are asking for is a little help, a little consideration and a little professionalism on the part of our mortgage holders.

If we are able to negotiate a more manageable payment plan to keep our home, it becomes a win/win solution for everyone. We keep our home, the banks avoid the cost of foreclosure and the community avoids a hit to property values and tax collections.

Senator, please do something to help struggling homeowners like my wife and I. Thank you again for the opportunity to tell my story.

Chairman WHITEHOUSE. Thank you, Mr. Verdelotti. I appreciate it very, very much.

Mr. Burlingame.

STATEMENT OF JEFFREY BURLINGAME, FIREFIGHTER, WOONSOCKET, RHODE ISLAND

Mr. BURLINGAME. Senator. Good morning, Senator Whitehouse and thank you for the opportunity to be here today. My wife wanted to join us but she was unable to attend due to work. She works as a freelance technician for a TV station in Boston.

My wife and I bought our home on May 24, 2006 for $319,000. The house was appraised at approximately $350,000. We believe this was around the peak of the real estate bubble.

Since we did not have money for a down payment, we took out two mortgages, a so-called 80/20, the 80 percent mortgage carried a 7 percent fixed interest rate for 3 years. After June 1st, 2009 that interest rate could change once per calendar year with a minimum rate of 7 percent and a maximum rate of 13 percent.

The 20 percent mortgage was a 9.25 percent fixed rate with a balloon payment. This means that the entire remaining balance would be due on June 1st, 2036.

According to the city of Woonsocket's tax reevaluation, our home is worth $247,100. This means we have lost nearly 30 percent of our home's value in 3 years.

On March 31, 2008, my wife and 30 of her colleagues were given layoff notices from their employer, the Boston TV station. Two months later she began working as a freelance broadcast technician at another Boston television station. While we had hopes she might be able to get hired full time somewhere, the television market nationwide suffered major job losses and cutbacks. This has made her chances of securing a full-time job in her field virtually impossible.

Fortunately, my career is secure. I'm a firefighter with the city of Woonsocket. I will complete my 12th year of service on February 23rd, 2010.

On September 25th, 2008, my wife and I were able to refinance our 80/20 mortgage with Wells Fargo into one 6 percent fixed rate 30-year mortgage. In October of 2008, my wife experienced a lack of hours at her freelance job. She was forced to collect unemployment while working only 1 to 2 days per week. Our take home pay dropped by about $300 per week.

On December 11, 2008, we suffered another financial blow. My wife seriously injured her wrist while riding on a shuttle bus. Her only choices were to either live with the pain for the rest of her life or undergo a partial or possibly full wrist fusion. We decided to go with the surgery which she had on March 12, 2009.

Due to the nature of her job, my wife was unable to work for 2.5 months. During that period we lost close to $10,000 in pay. On April 17, 2009, we requested a loan modification with Wells Fargo. We hired an attorney to help us through this process.

On April 23, 2009, we submitted our financial information and all necessary paperwork. On May 11th, 2009, we received a letter from Wells Fargo stating that our account was in review.

One week later my wife logged onto Wells Fargo's website to submit our June mortgage payment as she has done several times prior. She quickly realized that our online privileges were suspended. She called Wells Fargo and stressed to them her concerns about not being notified in the change of our online status. After all, we were still getting email notifications of new statements to view, but we were now blocked from viewing them. We were never notified of this change. They didn't send us anything.

Wells Fargo issued a verbal apology and told her to mail the check to them. Against her better judgment, she sent the payment that day via the U.S. mail without certification or return receipt. She called Wells Fargo on June 1st and she was told there was no record of her payment and to call the post office.

My wife told them she was going to call every day until she had confirmation that a payment was received. They told her that wasn't necessary, to call at most once a week. They told her we had until the 15th of June to submit the payment or a late fee would be assessed.

On June 8th, we decided to put a stop payment on the check and to pay the bill over the phone. On June 16th, Wells Fargo attempted to cash our canceled check. According to our records, we would have been 1 day late. Fortunately we paid by phone.

For the July and August payments, we sent our mortgage check via certified mail. Even though it took several days for Wells Fargo to clear the check, at least we had proof and peace of mind that it was there.

While our account was in review, we received mail correspondence and phone calls from Wells Fargo asking us for more information. We received approximately four phone calls on different days of the week asking us for more information. Each and every time we told the person who was calling us that we had retained a lawyer and all questions and requests for additional information should go through that office.

Each and every person said they were unaware we had a lawyer, but none of them asked for our lawyer's contact information. They repeated their request for information, and when we refused to speak with them, they hung up.

On July 4, 2009, our loan modification from Wells Fargo was denied. They cited this request would be outside of your investor guidelines. Our lawyer's office told us Wells Fargo said we had an $800 a month deficit in income which is why we were denied, and we didn't qualify for the next step. On July 14th we resubmitted our request since my wife's hours at work increased. Since then, our lawyer contacted Wells Fargo and questioned them about how they generated our financial information and the accuracy of it.

Our lawyer discovered that they were looking at an old credit report, ignoring our financial worksheet and said we had a second mortgage and we owed almost $2,000 a month on car payments. We do not have a second mortgage and our car payments total well under $2,000 a month. As of today, our file is still under review.

My wife and I are working hard to retain our home. It seems to us that Wells Fargo would rather foreclose upon our house than follow the law and renegotiate our mortgage terms.

In closing, we can only hope that President Obama's Making Homes Affordable Act is followed by all lenders as it was intended to be. My wife and I thank you for the opportunity to tell our story here today. We urge you to consider bankruptcy reform among other ways to make sure loan companies work to keep people in their homes. Thank you, Senator Whitehouse and God bless America.

Chairman WHITEHOUSE. Thank you, Mr. Burlingame.

Mr. Pollock.

STATEMENT OF DAVID POLLOCK, HOMEOWNER

Mr. POLLOCK. Chairman Whitehouse, thank you for inviting me to testify this morning. I am here to present my personal experience attempting to get a loan modification on my home mortgage service by Wells Fargo.

In 2008, I had a dramatic decline in earned income from real estate commissions as a real estate broker and the misfortune of owning real estate investments that were under water.

Although I have extensive real estate finance experience, navigating the Wells Fargo process was extremely time consuming and continuously full of conflicting and incorrect information.

Since 2002, I have been in my own business to purchase, renovate and sell multi-family real estate in the Providence area and have also worked as a real estate sales person.

In 2005, I purchased two multi-family buildings in Cranston. The mortgages on both buildings are serviced by Wells Fargo. Fannie Mae is the investor. In 2007, I sold my then residence in Lexington, Massachusetts and moved into a unit in one of the Cranston properties located on Armington Street.

In December, 2008, my Armington Wells Fargo mortgage payment of $3,500 had become unaffordable. With a high 7 percent interest rate that had been established when the property was non-owner occupied and the property value having declined by 50 percent, I thought the bank would modify the loan.

With excellent credit and being current on all debts, I contacted Wells Fargo with the goal of avoiding any bankruptcy. I submitted detailed financial statements with a hardship letter. Wells Fargo arranged a moratorium on the loan with no payments required until May.

I had the understanding that at the end of the moratorium, my interest rate could be lowered, the loan term could be extended, and principle could be written down to market value.

During those months, I never received a call from Wells Fargo, nor had any account executive working with me to determine an acceptable plan. The few times that I did call from February through April, I was told my loan was under review for modification.

Since I did not have an answer at the end of the moratorium, the Loss Mitigation Department told me to resubmit all information to start the process again. I called and spoke to a Wells Fargo Loss Mitigation representative who told me that the package had been received and was submitted for review.

I was told that I needed to call every week to find out the status. I called almost twice a week through June and was told every time that my application was under review and there was nothing more that I could do than continue to call every week and ask about the status.

It was very frustrating to not know what changes I should make that could change my finances such as selling a property for a loss or getting a salary job to be able to meet qualifications for one of the loan modifications.

On June 4th, I received a foreclosure letter from Harmon Law Offices on my Armington loan. I called both the Harmon office and Wells Fargo. Wells Fargo told me that the foreclosure process will continue while my loan is being reviewed for modification. I was told that if I paid the outstanding balance owed of over $17,000, they would cancel the foreclosure sale.

That was not possible for me since I did not have that much cash. I later became aware that all the information I submitted on May 1st was actually never looked at or entered into the Wells Fargo computer system.

Now, 6 months after this process began, I had little time to make more dramatic changes to my financial situation. Nobody told me back in January that I needed to meet certain financial criteria for a loan modification.

Since June, I have spent huge amounts of time every couple of days calling Wells Fargo. Every time I speak with a new person and ultimately get different information. I received conflicting information numerous times. I spoke with people in the foreclosure, short sale, loss mitigation and customer service departments. In all cases, I could not get one person who was in charge of my account. I could only speak with representatives who would make notes and read something from a computer screen.

On July 9th, a supervisor in Loss Mitigation was the first person I ever talked with that seemed helpful. I found out that I had been rejected from the review program a week earlier, even though no one ever called to tell me or inform me the times that I did call.

I found out that I was rejected because I made too much money. All my rental income was mistakenly counted twice. She once again corrected errors that had been entered into my financial statements and once again requested that I be reviewed for a loan modification.

Two hours later, a negotiator called me for the first time ever. She did not have the information for the loan on my residence, but rather the loan on the other investment property. She said I didn't qualify for any programs because my income was too high. I once again told her to correct the financial information. They too had counted all my rental income twice.

Then she put me in a program to pay half of my mortgage payment for 6 months with the goal of a lower interest rate and term extension. I implored her to be in charge of my Armington loan, but the best she could do was to email the Armington negotiator to call me.

Two weeks later I spoke with another supervisor who needed to correct the same income information on my financial statement. I now learned that there were two separate computer systems that did not share information.

If you were under review, they entered information into one system, and if you were not under current review, your information went to another software program.

Three days before the foreclosure scheduled on Friday, August 14, just a few days ago, the sale was postponed. On Friday morning, Fannie Mae called to tell me that they approved a loan modification based on 31 percent debt to income in order to lower my interest rate to 5 percent in the new payment starting in November.

Later when I called Wells Fargo, I was told that a payment agreement was being sent out for me to make my current payment of $3,500 a month for 3 months.

After the 3 months, I would need to submit new financials for a loan modification to be reviewed. The Wells Fargo customer service representative did not know anything about the information that Fannie Mae had told me just that morning.

Since the Fannie Mae modification was solely based on my income and expenses, I asked Wells Fargo to tell me what was in

their system. I could not understand how they had come up with a surplus of almost $650 when a couple of weeks before I had a monthly loss of almost $1,000.

After I did a detailed review, I discovered that the Wells Fargo numbers did not include any cost for the investment property mortgage payment which Wells Fargo also services.

At the moment, I do not think that the Fannie Mae modification with a decrease in my mortgage payment by $600 is affordable. With an outstanding balance on my Armington loan close to $430,000 and a market value near $200,000, I need to consider all alternatives.

If my loan servicer won't agree to write down the loan closer to the market value, I might have to do a short sale, move out and the new owner can happily afford to live in my home with only a $200,000 mortgage.

Like thousands of homeowners in Rhode Island, I continue to be penalized for having bought property at the peak of the housing bubble. Senator, please help us stay in our homes.

Chairman WHITEHOUSE. Thank you, Mr. Pollock.

Ms. Bodington.

STATEMENT OF SUSAN BODINGTON, DEPUTY DIRECTOR FOR PLANNING, RHODE ISLAND HOUSING

Ms. BODINGTON. Thank you. On behalf of Rhode Island Housing and our partners, we'd like to thank you, Senator Whitehouse, for the opportunity to present this testimony.

I'd like to provide a synopsis of the impact of the foreclosure crises in Rhode Island, the impact it has on Rhode Islanders. My goal is to outline what we are doing and what can be done to help those at risk of losing their homes during this confluence of financial, housing and unemployment crisis which has been called the Perfect Storm.

Rhode Island ranks 10th in the Nation for foreclosures and the numbers continue to climb as lenders act on a backlog of recent defaults. In addition, the unemployment rate in Rhode Island is over 12 percent. It is much higher than the national average and is continuing to go up. It has been projected to reach 13 percent and it is also projected that it might take another 5 years for that unemployment rate to go back down to normal rates.

Third, there is a decline in property values as a result of this housing crisis which has exacerbated the situation for many homeowners. In several Providence neighborhoods, we've seen depreciation by as much as 60 percent of the appraised value and depreciation in urban communities surrounding Providence on an average of 35 percent. So these three factors are severely impacting the housing market in Rhode Island.

The past 6 months have been particularly difficult for Rhode Islanders from a housing perspective. Foreclosure initiations increased by almost 44 percent during the first 6 months of 2009 compared with 2008. That's an estimated 5,600 plus Rhode Islanders who received notification that foreclosure proceedings were initiated on their homes. We know that over 1,000 Rhode Islanders actually lost their homes to foreclosure in the first 6 months of 2009 alone.

More than 7 percent of Rhode Island mortgage holders are severely delinquent according to the most recent data that is from the Mortgage Banker's Association. It is noteworthy to see that Rhode Island Housing's mortgage delinquency rate using the same statistics is only at 1.96 percent. There is a significant difference there which is attributed to conservative lending practices that we've always practiced, a mission based strategy to help Rhode Islanders make safe and informed decisions to buy and keep a safe and healthy home that meets their needs.

While the rate of homeowners losing their homes is indeed very troubling, we also need to be aware that that is only part of the story. For every homeowner that loses their home, there are a number of other families who had been renting in these multi-family properties who have also lost their homes, some of them multiple times, and have had to move.

Up until very recently, these renters received no advanced notification at all, as is done for homeowners. We'd like to thank Congress for legislation that was recently passed that at least allows and requires that tenants have at least 90 day notice before they are asked to move. The problem will still exist. We still have many tenants having to move out of their property.

Finding a new affordable home to rent is not easy after a foreclosure or for those tenants. Although we are seeing a dramatic decline in values in some areas, it is still difficult. When you compare wages in Rhode Island to housing prices, we are second only to Hawaii in the size of that gap. It is very difficult for renters and for former homeowners to be able to afford rents.

In addition, during the first 6 months of 2009, 41 percent of the sales in Rhode Island were for distressed properties, either foreclosures or short sales. When you take those out of the mix and look at the actual price of homes sold that were not distressed sales, the average price was still at $235,000 throughout the state, and that is not affordable to most Rhode Islanders.

What are we doing to help? Rhode Island Housing's Help Center is assisting more Rhode Islanders than ever since opening our doors in 2007. We have assisted more than 5,000 Rhode Islanders, 3,226 in the past 12 months alone.

We have a whole team of counselors who are experienced lenders and mortgage servicers and they are dedicating their time to helping any Rhode Islander who comes to our door.

On average they are spending 8 to 10 hours working with each client. Each one has their financial situation assessed to help them understand their options and to develop a plan of action. Each situation is unique.

Our counselors help homeowners through foreclosures, whenever possible to avoid foreclosures or to look at their options if that's not possible.

Many times we are helping homeowners and renters recover from the loss of a home and looking for other housing opportunities and linking them up with services in the community.

To date, the Help Center has had outcomes for 1,900 customers who have completed going through counseling, and there are a whole variety of outcomes that are possible. Anything from mitiga-

tion to bringing their mortgage current to refinancing. As I said, every situation is unique and it has its own solution.

We currently have 808 client files that are being reviewed for workout with service and 125 modification plans that have been processed through the Home Affordable Modification Program, HAMP, and are currently in a 3-month trial period.

Due to the high volume in that program since last winter, the largest lenders that we're dealing with have very slow response time and have continued delays in communication and in responding to our counselors. Even where they appear to really be trying to work with our lenders, it is still taking 60 to 120 days to get a response and work out any kind of modification.

Although the program was introduced in March, we are just beginning to see some modification plans being approved. We are hopeful that that is a sign that approval of those will accelerate, but we are still seeing a lot of problems in communicating with financial institutions. It is a very long process, it is very frustrating for homeowners and our staff is very experienced in working with servicers, but it is still a long process.

More than ever it is important for homeowners to contact a HUD-approved counseling center like Rhode Island Housing within the state for assistance, whether they are looking for a modification or looking for help with their mortgage.

We have a couple of examples. I will give you just one. It was a single woman struggling to pay her adjustable rate mortgage that came to our help center. She was ten payments behind. She negotiated with her lender who had offered her a fixed rate loan at 10.6 percent plus $5,000 down payment to modify her loan and it would have increased her payments by $400 a month. Clearly she already couldn't pay the mortgage that she had.

Having come to our Help Center, we were able to negotiate with the servicer and after 3 months of negotiating, we were able to get her a fixed rate of 7.5 percent and we were able to extend her payments and reduce her monthly payment from what she currently was trying, struggling to pay by $450. So those negotiations although they are long and they are complicated, they have been successful in many cases.

What more can we do? Despite our tireless efforts and the efforts of our partner agencies in the community, there remains much work to be done to recover from the ongoing foreclosure crisis.

It is more crucial than ever that the Federal Government continue to fund housing counseling services in the community which have played a vital role in helping Rhode Islanders keep their home or find alternatives.

In addition, we need to seek out new opportunities to provide gap funding for homeowners who can't make their mortgage payments but need additional support to qualify for a loan modification.

As we work to keep Rhode Islanders in their homes, we need access to a wide variety of mortgage restructuring options, providing flexibility to increase loan terms to 40 years, provide short-term interest only payment periods for FHA insured loans would give us more tools with which to work.

As we continue to focus on recovery from the crisis, our ability to work collaboratively and cooperatively with banks, mortgage

lenders and servicers in modifying loans in a manner that truly helps homeowners address the situation while we still protect the interest of the lenders is critical.

As I mentioned earlier, the current workout process is very arduous. It takes months when working with lenders. In short, it simply does not work in the majority of cases and cannot work for the volume that's in the pipeline.

One solution to address the process delays would be for Congress to implement reasonable modification plan time limits for authorization and assignment to a negotiator and a maximum of 60 days to complete approval of a modification.

Bankruptcy reform could provide the incentive or pressure to expedite workouts and collaborate more effectively, but it should be structured in a way that does not penalize responsible lenders who have made fair loans that were in the best interest of the customers when the loan was made and who have worked with their customers compassionately to keep them in their homes.

While some lenders, especially locally based financial institutions are working diligently and efficiently with borrowers to modify loans and keep families in their homes, our Help Center's experience with some large national lending institutions has been for less productive.

Significant delays in communication and slow processing times can result in a negative outcome for the homeowner along with additional hardship and stress for the homeowner and the entire family.

We appreciate your commitment, Senator, to this issue and we thank you for giving us the opportunity to share our experiences with you and we look forward to continuing to work with you to address this crisis.

Senator WHITEHOUSE. Thank you very much. Finally

Mr. Rao.

STATEMENT OF JOHN RAO, NATIONAL CONSUMER LAW CENTER, BOSTON, MASSACHUSETTS

Mr. RAO. Senator Whitehouse, thank you for holding this hearing and for inviting me to testify about the voluntary loan modification programs and the potential role for bankruptcy courts in solving foreclosure crisis.

Senator WHITEHOUSE. Just one technical matter. As you know, your full statement will be entered into the record of the proceeding. I understand you'll make a shorter statement than the full statement you provided.

Mr. RAO. We are now 3 years into the foreclosure crisis, and sadly there have been no signs of improvement. The statistics are grim and Ms. Bodington has told us about what is happening in Rhode Island. Nationally approximately 300,000 homes are going into foreclosure every month.

The first quarter of this year we saw that there were 2 million homes in the foreclosure process and an incredible 25 percent of subprime mortgages are seriously delinquent.

All of these statistics are record breaking and suggest that we are facing the greatest foreclosure crisis since the great depression.

Senator Whitehouse mentioned that the projections are for there to be 9 million foreclosures in the next 4 years. This may well underestimate the problem as recent reports indicate that there may even be greater problems or a new wave of foreclosures that will take place concerning what are called Alt A mortgages.

These are mortgages that were generally given to buyers with higher credit scores than subprime borrowers but were made with nontraditional underwriting standards. Often they were just stated income loans.

One rating agency, Standard—last month downgraded the ratings for the mortgage backed securities for these Alt A mortgages that were made in 2005 to 2007 based on the higher unemployment rates and the continuing problems in the housing market. So I think that is going to be a serious problem that we are absolutely going to need to deal with.

The administration's HAMP program, the loan modification program, has attempted to overcome problems with the earlier voluntary programs. While it may be still too early to judge the success of hamp, so far the results have not been impressive.

In fairness to the administration, there is only so much that a voluntary program can do to overcome some of the structural barriers that prevent services from modifying loans.

The first HAMP progress report is now in. During the first 4 months, again, as Senator Whitehouse mentioned, approximately 230,000 trial modifications have been made. This is a small part of, again, as I mentioned, the number of foreclosures that are going into, homes that are going into foreclosure every month.

But what is probably more of concern is that there are some mortgage servicers who are just not even putting a dent into the number of homeowners eligible for HAMP. Bank of America, Wells Fargo, Aquin and Wachovia, while they have an estimated according to the Treasury figures, 1.2 million homeowners who are 60 days delinquent who would be eligible for the modification program, they have only extended modifications or trial modifications to 2 to 4 percent of that eligible group.

There is another servicer with 37,000 potential homes that are about to be in foreclosure who has made no modifications at all. The Treasury, the major problems with the HAMP program are as follows. Large numbers of homeowners have been told that they are not eligible for HAMP or are being steered by the services to non-HAMP, non-Treasury approved modifications.

For example, 37 percent of Chase's recent trial modifications were not HAMP modifications because they claimed that the borrowers were not eligible for the Treasury program. This raises many questions. Why are so many homeowners being turned down for the Treasury HAMP modification? How many other borrowers have applied and were completely denied modifications? And what are the terms of these non-HAMP modifications that a large number of homeowners are getting.

This leads to the next problem which is the lack of accountability. Like the witnesses have said today, homeowners are not told whether they were processed for HAMP modification or some other modification. They are not even given confirmation that their

application is complete. In many cases they are not even given an answer at all.

If they get an answer, they are not told the reasons why they were denied a HAMP modification. The HAMP program itself does not require servicers to give this essential information.

Homeowners have encountered many bureaucratic problems, again, like the witnesses have said today. Homeowners files are routinely lost or shuffled between departments in the servicers operation. Homeowners and housing counselors report waits of months to hear back for review of a trial modification.

A recent story in the *Providence Journal* reported that a homeowner had submitted 99 pages of documents to support her application for a modification and 4 months later still has not heard back as to whether she has been approved.

Another major problem is with the problem of negative equity and the fact that these modifications do not have principle reduction. It is not required under the HAMP program and it is not happening.

The recent banking regulatory agencies reports for the first quarter show that of the Fannie and Freddie mortgages that were modified as well as private securitized mortgages, none of them involve principle reduction. The only principle reduction occurred in some of the loans that are called portfolio loans that some of the smaller banks hold themselves. Even that was minuscule, only at about 5 percent.

Negative equity, as Ms. Bodington has said, is a big issue in Rhode Island. There are so many homeowners who owe more on their mortgage than the property is worth. The statistics are that it is likely that nationally that likely that 48 percent of homeowners who have negative equity before the housing market begins to improve sometime as projected in 2011.

The problem of course with negative equity is there are things happening all of our lives, we lose a job, we need to relocate and you need to sell a property, sell your home. If there is negative equity, you just can't do that. You are locked, you are basically trapped in your house.

More seriously, homeowners have no leverage to obtain a HAMP modification. Servicers are not even required to stop foreclosure proceedings as what happened with Mr. Pollock. They continue to process the foreclosures as they are handling the modifications and that increases foreclosure expenses, it can add thousands of dollars to the amount that the homeowner needs if they actually modify.

What is really lacking in the system is not a carrot. What is lacking is a stick. That leads to my final points, Senator Whitehouse, which is to discuss very briefly some of the advantages of having a bankruptcy option available to amend the bankruptcy code.

Unlike other enforcement mechanisms that the Department of Treasury or Congress might consider that would be subject, they will be subject to legal challenges and costly government administrative costs, bankruptcy court ordered modifications have been tested to withstand constitutional and administrative challenge.

There is already a court system in place that would oversee these modifications without the use of taxpayer dollars. It would also provide homeowners with a legal right to a modification even if the

servicer claims that their securitization documents don't allow modifications.

As mentioned, HAMP's greatest weakness is ensuring sustainable modifications, and that is probably because it doesn't involve principle reductions. The availability of the cram—right in bankruptcy in Chapter 13 which is to reduce the mortgage holder's claim to the value in the property. It is not to do it lower than that, but to reduce it to the true value of the property.

That will encourage services to do principle reductions outside of bankruptcy. That is certainly the case when Congress quite a few years ago allowed this cram down right for family farmers, for those who had farms. Many farm banks began to voluntarily reduce the principle on modifications without the farmer even needing to go to bankruptcy court. So that's a good example of how once it is in place, the voluntary efforts will improve.

Cram down would allow homeowners in foreclosure to repay their mortgages under fair and reasonable terms and to fully protect the mortgage holder, and again they would receive adequate protection.

Finally, a loan modification in Chapter 13 is provided for assistance for families who for one of many possible reasons are just not able to obtain a HAMP or other modifications. By being closely tied to HAMP as was proposed in the Senate bill and the bill that has been considered in both the House and the Senate in the past, it would allow servicers, it would really get servicers to work with homeowners and to make prompt decisions on their modification requests.

Just finally, it also deals with the fact that homeowners, many of the homeowners who are facing foreclosure have other debt that they are dealing with, maybe credit card debt and so forth, and the modification programs currently the Treasury program simply says if you have all this other debt, go to credit counseling, but doesn't have a way to address it.

At least for the homeowners who are in the worst financial situation, a Chapter 13 bankruptcy would allow them to deal with their mortgage plus dealing with their other debts. That would be likely to prevent these modifications from re-defaulting.

So many good reasons why we ought to consider a bankruptcy option. Thank you, Senator Whitehouse, for giving us this opportunity to testify today.

Senator WHITEHOUSE. Thank you very much. I want to turn to our personal witnesses first, but I don't want to leave your testimony without taking the opportunity to emphasize a point that you made at the end. I just want to make sure that you confirm it.

You have heard from these three gentlemen who lived through nightmares of bureaucracy and you heard Ms. Bodington describe the process is arduous and long and frustrating and a real ordeal for folks.

You indicated that if we were to pass the amendment that would allow a primary residence mortgage to have a principle reduced in bankruptcy the way every other loan can be, that there could be benefit to customers without ever needing to go near a bankruptcy court.

I want to just reemphasize that point with you because I think that is one of the key reasons we are trying to do this. We are not trying to drive Americans into bankruptcy to get this benefit. We are trying to send a market signal so that the nonsense that these servicers are engaged in stops and the only thing that will make them stop as you said is less carrot and little bit more stick. If they know that somebody can go to a bankruptcy court and get the relief that they need the way they can for any other kind of mortgage, the way the banks themselves can if they get in financial trouble and need their loan restructured, that it can work for the whole industry and the people like Mr. Verdelotti and Mr. Burlingame and Mr. Pollock could all be beneficiaries of this without ever having to go near bankruptcy court.

Mr. RAO. It's absolutely the case in my years, many years of when I had previously been a litigating attorney and was working at Legal Services.

When you are ever trying to negotiate something, when the other side knows that there are options available which may be worse for them, it makes them come to the table to negotiate it. It always has that effect.

Right now homeowners don't have that ability to say to the bank, well, if you won't modify this, if you won't be serious in your negotiations with me, there is another option which I can take. That was, again, this has been born out in truth with the example of the farmers who were able, the Chapter 12 was modified, amended to allow them to modify their mortgages. Once that change happened, many more voluntary modifications which involved principle reduction occurred.

Senator WHITEHOUSE. Mr. Verdelotti, you have heard what Mr. Rao just said. You have had your own experience.

Based on, as I recall from your testimony, you and your wife basically on a tag team basis handing each other the phone as you had to cope with the three kids and your jobs and all that sort of stuff, you were on the phone for a single longer than 5-hour segment just on one occasion.

They claimed that you had not mailed in your package until you were able to show them a receipt showing that yes in fact you had mailed it in. Not only that, they had received it and at that point they had changed their story to say oh, well the package was evidently lost then.

There was a 2-day turnaround. Everything else had taken forever, but there is a 2-day turnaround between when they get one package and when you get a denial.

Based on all of that, how seriously do you think the institution that you are dealing with took negotiating with you, how much leverage did you feel you had in those negotiations?

Mr. VERDELOTTI. None. I didn't have any leverage or anything of that nature. I didn't get any sympathy from them. Aurora turned around my denial in 2 days. Citimortgage, it took forever. It actually went to the Executive Unit and that didn't take much longer. It took maybe a week for them to actually tell me that I make too much money for them to help me, and Aurora tells me the exact opposite which we make not enough.

Senator WHITEHOUSE. And they're looking at the exact same information?

Mr. VERDELOTTI. Correct.

Senator WHITEHOUSE. Mr. Burlingame, you had a couple of observations that I wanted to highlight. One that you thought you had to send them your materials by certified mail in order for proof and peace of mind. That's not a sign of a very trusting relationship with your servicer, is that correct?

Mr. BURLINGAME. That is correct.

Senator WHITEHOUSE. I mean, do you feel that they were being cooperative and helpful on the other end of this? How would you describe the experience you had with your servicer in terms of how they treated you and whether you felt that they were friend or enemy?

Mr. BURLINGAME. When my wife and I started this process, we obviously ran into some difficulties quickly. I remember saying to my wife, I said Rachel, I said, there is no way you are going to tell me that a big company like Wells Fargo, somebody is sitting in a room somewhere holding—saying we got them.

I honestly can't say that I believe that anymore. I truly believe that there was some intentions on their part, for lack of a better term, play games with us. They had our check, they knew they had our check. They chose not to apply it.

Senator WHITEHOUSE. Now, let me go back to your testimony. You said on May 11th you received a letter from Wells Fargo stating that your account was in review and then 1 week later, Rachel logged onto Wells Fargo's Web site and then you said she sent the payment that day via U.S. mail. That is several paragraphs later.

That refers back to the 1 week after May 11th. So you are talking about having mailed the check in the week of May 18th, correct?

Mr. BURLINGAME. Correct. My wife handles a lot of this.

Senator WHITEHOUSE. But she would have mailed it, what your testimony refers to is she would have mailed it approximately in the week of May 18th.

Mr. BURLINGAME. Correct.

Senator WHITEHOUSE. And then they said they didn't get it, and it is due the 15th of June. So if they cash it on the 16th, you are technically in default.

Mr. BURLINGAME. It is due June 1st. They give you that 15-day period.

Senator WHITEHOUSE. Grace period.

Mr. BURLINGAME. A grace period.

Senator WHITEHOUSE. So you know that, you know two things. You mailed it the week of the 18th.

Mr. BURLINGAME. Right.

Senator WHITEHOUSE. They said that they didn't have it, but they sure as hell cashed it on June 16th, that 1 day that put you outside of the grace period.

Mr. BURLINGAME. Right.

Senator WHITEHOUSE. Or at least tried to if you hadn't stopped payment on it.

Mr. BURLINGAME. Right. Fortunately she was right on the ball with this. We put a stop payment on the check and we paid by phone.

Senator WHITEHOUSE. Between this and between the magically missing file that Mr. Verdelotti sent in, it begins, there begins to emerge a whiff of gamesmanship and manipulation through all of this. What would your feeling be? You are the ones who experienced it firsthand.

Mr. VERDELOTTI. Yes. It seems like they are doing this, you know, to make things harder. I mean, if we are having a hard time doing this, what is everybody else doing? Everybody is going through the same problems right now.

We need that step. We need something to make them move along most definitely. This seems intentional.

Senator WHITEHOUSE. And why would it make sense, John, why would it make sense for a servicer to want to discourage participation in the process with all these different games and I assume that what happens at that point is if you give up, you mail in the keys, you go to foreclosure and, you know, that is the outcome that they force you toward.

Whose interest is it, in whose interest is it to have the property go to foreclosure?

Mr. RAO. Well, Senator Whitehouse, it's a great question and I don't know what the real answer is. It doesn't really make any logical sense for this to be happening, but there are so many different ways in which servicers have financial incentives that are counter to what homeowners and especially modifications are that——

Senator WHITEHOUSE. So the servicer might be looking at financial outcomes for the servicer that are better if the homeowner goes into foreclosure than they are if they continue to work with the homeowner and put them back onto a salvageable footing?

Mr. RAO. There certainly seems to be that. I mean, they are recovering all of their costs, you know, interestingly from the investors of the mortgagees if it goes to foreclosure. They do recover those.

The cost of processing these modifications, the Treasury program for the first time does give them some money, but it's not clear that they see that as being enough of an incentive. And there are admittedly a lot of administrative costs that the Department of Treasury has imposed upon them.

Quite frankly, I think they may see this as it is just better to have the house go to foreclosure and we'll get our costs back and it might hurt this investor, but at least we are OK. We are not going to get reimbursed for our cost to make sure that the modifications are processed properly.

Senator WHITEHOUSE. Mr. Pollock, you are an obviously experienced investor in the real estate market and a professional in this field. Your experience doesn't seem to have been any better.

No account executive was ever assigned to work with your account as I understand it until very, very late when finally somebody in Loss Mitigation appeared willing to take a little bit of responsibility.

At one point you were advised that you had to resubmit all the information and start the process all over again even though pre-

sumably they already had all the information and you found it extremely time consuming and continuously full of conflicting or incorrect information.

Ultimately you discovered that all the information you had submitted was actually never looked at or entered into the Wells Fargo computer system. Again, how would you categorize the manner in which you were treated by the servicer through this process?

Mr. POLLOCK. I think it's extremely unfair and it is possibly because of two reasons. One, I guess I could imagine somebody is massively disorganized because when I was in the banking industry, everybody had their own clients. So if I had just one asset manager who was in charge of my account, then that person would make sure they had all the information on me.

In the Wells Fargo procedure, it is as extreme opposite as you can get because you could never speak to this person who is actually in charge of your account.

Senator WHITEHOUSE. Ms. Bodington, you make a very interesting point in your testimony. You say that the current workout process is very arduous and takes months. You say that it simply does not work in the majority of cases. Then you say something more interesting. You say that it cannot work for the volume of cases in the pipeline.

So something is going to have to change if this is going to be effective, correct?

Ms. BODINGTON. Yes. I think it is a guess on our part, but I think we are seeing, I think our counselors have the same frustration with the amount of time it takes, getting responses, getting to talk to someone who actually has responsibility for a loan and can take some action.

But some of that problem I think with the larger banks, we're making an assumption that some of it is confusion based on there is so much in the pipeline, there are so many loans nationally that need to be modified that even a very large institution even with the best intentions we are seeing conflicts between departments having different information as you've heard from some of the homeowners.

I think our staffers are seeing all of the same problems with the system. We are getting modifications through. We are seeing homeowners with modifications that we think that they can afford and they will be able to keep their home, but it's a very, very difficult process.

Senator WHITEHOUSE. And that's even with your experienced staff here at Rhode Island Housing assisting them. This is not them out on their own accomplishing this. This is with your expert assistance.

Ms. BODINGTON. Yes.

Senator WHITEHOUSE. And even then it is long and frustrating and arduous.

Ms. BODINGTON. Yes. Any homeowner on their own trying to work their way through the system, it would be very difficult without some help from an experienced counselor, and even then it's a very difficult process.

Senator WHITEHOUSE. So for Mr. Burlingame to have turned to the advice of a lawyer makes perfect sense in terms of the, assum-

ing the lawyer has some expertise in this area in terms of it not be just him and his wife trying to sort it out against the bank.

Ms. BODINGTON. Yes. I think homeowners really do need help with it, and there are a number of counseling agencies in Rhode Island where homeowners can get that kind of help and they can actually get it for free.

Fortunately there is some good funding coming out of Washington through Neighbor Works for counselors in the community. But this is a very complicated process and homeowners really do need help with it.

Senator WHITEHOUSE. And without your help, in the example that you gave, the so-called help that the servicer offered would actually have increased the woman's mortgage payment by nearly $400 a month.

Ms. BODINGTON. That's correct.

Senator WHITEHOUSE. That's a very interesting kind of help when a person is struggling with a mortgage payment, isn't it?

Ms. BODINGTON. Yes. But fortunately there was a solution for that woman there. A number of, I think each case needs to be individualized and take a look at what they can actually afford. I don't know whether the financial institutions have adequate staffing to take the time to really look at that or not.

In that particular instance, fortunately we were able to offer an alternative plan that did work.

Senator WHITEHOUSE. You did note in your testimony another point that I'd like to emphasize, you have perceived a distinct difference between the local banks and the big national banks in terms of the quality of the interaction between your clients and customers and them.

Do you think that is just a question of sort of local community sentiment? Or does it also relate to the portfolio issue that Mr. Rao referred to that if they actually have held the mortgage, they are in a better position to consider reducing its principle and adjusting its terms than if they are a servicer for a bunch of investors all over the world who they don't even know who have bought that mortgage up in strips?

Ms. BODINGTON. Yes, I think that's an important distinction. I think its local financial institutions that service some of their own loans, and Rhode Island Housing, we service all of our own loans, who are able to meet with our customers and work out modifications.

So part of it is volume and part of it is just having that local presence and being responsive to residents when they do need help.

Senator WHITEHOUSE. And that's why you have less than 1/3 of the delinquency rate of statewide.

Ms. BODINGTON. Yes, correct.

Senator WHITEHOUSE. It is a point worth making in this hearing and in our community that to the extent local banks are involved and to the extent that loans have been held by those banks in the portfolios, you see a far, far, far smaller problem and the kind of mistreatment that Mr. Verdelotti, Mr. Burlingame and Mr. Pollock have been treated to appears to be associated with and was in each of their cases associated with national banks that don't have that local touch.

Ms. BODINGTON. I think the local smaller institutions have much lower foreclosure rates, have far fewer issues, and when they do have issues, they are better equipped to be able to work with homeowners and keep them in their homes.

Senator WHITEHOUSE. Mr. Rao, let's try to put ourselves for a moment in the shoes of the servicer and assume that they are in some way trying to do the right thing here. All evidence at this hearing to the contrary.

But if they are servicers and somebody's mortgage has been turned around and resold and has been carved up into all these strips that we've read about and then each of those strips have been sold to investors in different funds all over the country and all over the world, if you are the servicer and you are on the phone and you have got Mr. Verdelotti or Mr. Burlingame or their spouses on the phone, you have got two parties to the equation there who in theory could work it out except that somebody actually owns that mortgage.

What happens when that group can never be assembled and the servicer can never get a decision out of the investors? Does that affect this problem?

Mr. RAO. Yes, it absolutely does affect the problem. The services do have some general guidelines that are provided in the agreements which set up these trusts, and they vary from trust to trust.

Generally they are given some guidelines with regard to some minor modifications. But certainly when it comes to things like the modifications that many homeowners need, and especially involving the possibility of principle reduction, they are reluctant to do anything like that without getting authority from investors.

The problem is that there is no one to turn to. The way these were structured for a lot of the tax reasons and so forth is that they are supposed to be passively administered. There is not supposed to be the trust, the actual owners of the mortgage aren't really supposed to have involvement with the day to day activities of these loans.

Senator WHITEHOUSE. It was never really set up to be that way.

Mr. RAO. It's a system that is set up not to deal with the problem that we are facing today.

Just one other minor point. The other big issue is that we are now asking these mortgage servicers, these are the companies that were generally hired to collect payments and so forth to, as part of this modification process, to effectively underwrite these modifications.

They are asking for all this income documentation and stuff. They never did that before. What is even more ironic is that when many of these loans were made, the originating lenders never asked for any of this information. So they are actually asking for more information now to modify a mortgage than they did when they originally made the loans.

Senator WHITEHOUSE. I hear a lot of knowledgeable laughter from the audience on that point. Rather wry laughter it sounds like.

That is what you are referring to in your testimony. You talk about the dynamic that leads servicers to refuse even loan modifications that would be in the investor's best interest.

Mr. RAO. That's right.

Senator WHITEHOUSE. Well, I think I will call this hearing to a conclusion. I want to thank all of the witnesses for their testimony and for their expertise and for their commitment.

I particularly want to thank Mr. Verdelotti, Mr. Burlingame and Mr. Pollock for sharing their stories. It really makes it real when people like you are willing to come in and walk us through what you have been through.

As Ms. Bodington said, these are tough times in Rhode Island and a lot of families are struggling. There are a lot of those late night conversations when the kids are in bed and mom and dad have to sit around the kitchen table and figure out if they can make it another month.

That's a lot of stress, and losing a home is about as stressful as you can get. Particularly if it's a home with children in it. So for this industry to add into that equation what every single person, both you from your personal experience and you both from your more general expertise have described as a true nightmare of bureaucracy, that's a lot to add into it as a very already difficult mix.

As a lawyer and somebody who has seen workouts in various forms, in the business community people don't treat each other this way. If you really need to get into the court, and I see some heads nodding. If you really need to get into the court to get it done, then you have a judge and ultimately the decision gets made and there is no more nonsense and everybody knows about it.

That is one of the benefits that judges provide. They provide a decision and it is over and the long ordeal is finished. People who aren't present and don't want to show up for a voluntary negotiation, it doesn't matter. If they don't show up, they lose. You force the process. There is some real value to that. Knowing that that is coming, businesses make deals and they negotiate their way through and they get out.

When these banks were in trouble, they were eager to renegotiate all of their loans. So it seems to me that this would be fair to look further at this.

I take Ms. Bodington's statement that we have to be careful in looking at the principle reduction aspect of the bankruptcy loan modification to not target, for instance, the small local banks who are in fact granting these modifications, who are in fact working with people who did in fact make responsible loans in the first instance. Organizations like yours whose default rate shows that you made responsible loans from the get go and that the statewide rate is multiple times higher than yours, the delinquency rate. But it confirms for me the importance of trying to fight our way forward for this.

Leaving it to bureaucracy and leaving it to the unsupervised private sector simply doesn't seem to be making the difference.

So you have all been very patient. If anybody has any final closing words, I'd be happy to entertain them. But if not, we'll consider

this hearing of the subcommittee adjourned with my gratitude to you for your testimony and my assurance that it will be in a meeting when we get back to Washington and pursue this issue.

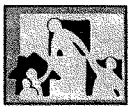
Clearly if, as Mr. Rao has suggested, there is a second wave of foreclosures coming, it will continue to be an important issue. As Ms. Bodington has suggested, we are still in our wave of foreclosures here, so this is not something that is just in the past. We really need to cope with this and I thank you for your help to us.

The hearing is adjourned.

[Whereupon, at 11:18 a.m. the hearing was adjourned.]

[Submissions for the record follow.]

SUBMISSIONS FOR THE RECORD



RhodeIslandHousing
working together to bring you home

Senator Sheldon Whitehouse Senate Judiciary Committee Field Hearing
Testimony from Susan Bodington, Deputy Director for Programs, Rhode Island Housing

August 20, 2009

On behalf of Rhode Island Housing and our partners, we would like to thank you for the opportunity to present this testimony. I'd like to provide a synopsis of the impact of the foreclosure crisis on Rhode Islanders. My goal is to outline what we are doing - and what more can be done - to help those who are at risk of losing their homes during this confluence of financial, housing and unemployment crises, which has been called a "perfect storm."

Rhode Island ranks **10th in the nation for foreclosures** and the numbers continue to climb as lenders act on backlogged and recent defaults. In addition, **the unemployment rate in Rhode Island for May 2009 was 12.1 percent**, again eclipsing the national unemployment rate of 8.9%. Originally economists had predicted Rhode Island's unemployment would peak at 12%. They have now revised that closer to 13 percent and are predicting at least another five years before the state's jobless rate shrinks to the 6 and 6.5 percent rates experienced in late 2007 and 2008.[i]

The decline in property values has exacerbated the situation for many homeowners. In several Providence neighborhoods, we have seen depreciation exceeding 60% of our original appraised value. Depreciation in the urban communities surrounding Providence is averaging 35%.

The past six months have been particularly difficult on Rhode Islanders from a housing perspective. **Foreclosure initiations increased by almost 44 percent** during the first six months of 2009, compared to the same period in 2008. An estimated **5,669** Rhode Islanders received notification that foreclosure proceedings were initiated on their homes, and **1,167 Rhode Islanders lost their homes** due to foreclosure in the first six months of 2009 alone.[ii]

About **7.09 %** of Rhode Island mortgage holders were "seriously delinquent" (90+ days and in foreclosure) as of March 31 2009, according to the most recent data from the Mortgage Bankers' Association. However, it is noteworthy that by comparison, Rhode Island Housing's "serious delinquency" remains very low. Our delinquency rate in this same category, for this same period, is **1.96%.** The significant difference can be attributed to our conservative lending practices and our mission-based strategy of helping Rhode Islanders make safe and informed decisions so they can afford to buy and keep a safe and healthy home that meets their needs.

While the rate of homeowners losing their homes is indeed troubling, these numbers tell just part of the story. For every homeowner that loses his or her home to foreclosure, an average of

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four to five families living in multi-family properties lose their home when the building is foreclosed upon. In fact, a recent report by Rhode Island Legal Services estimates that 5,887 Rhode Islanders were forced to move in 2008 as a direct result of foreclosure.

Until very recently, while owners received a minimum of 21 days notice of foreclosure, on top of notices when they are 45 and 90 days delinquent in their mortgage payment, tenants living in multi-family homes could be evicted with as little as three days' notice, even if they were responsible tenants paying their rent on time. Thanks to legislation passed by Congress this spring with the support of our Congressional delegation, those tenants are now entitled to at least 90 days notice.

Finding a new affordable home to rent after a foreclosure is not easy. According to the National Low Income Housing Coalition, the gap between what people earn in Rhode Island (the mean renter hourly wage, $12.01/hr) and the Housing Wage (the wage renters need in order to pay for housing, $18.76/hr) for a two-bedroom apartment is greater in Rhode Island than in any state except Hawaii. Also, Rhode Island ranked 13th nationally in the cost of rental housing. Making matters worse, only one of the state's current and growing top 10 occupations earns the report's Housing Wage.

Despite the decline in property values, finding an affordable home to buy also remains a challenge, particularly for first time homebuyers. According to an analysis by HousingWorks RI of data just released by the Rhode Island Association of Realtors, during the first six months of 2009, 41% of sales in Rhode Island were for distressed properties. When those distressed property sales are removed from the median sales price calculation, the single-family median sales price during the first half of the year increases from $189,000 to $235,000. A household in Rhode Island would need to earn $71,327 to afford that home.

What we're doing to help

Rhode Island Housing's HelpCenter is assisting more Rhode Islanders than ever. Since opening its doors in 2007, our HelpCenter has assisted more than 5,108 Rhode Islanders – 3,226 in the past 12 months alone. Our counselors, who are experienced lenders and mortgage servicers, dedicate a great deal of time and effort to help Rhode Islanders. On average, counselors spend 8 to 10 hours working with each client to clearly assess their financial situation, help them understand their options, and develop a plan of action customized for each unique situation.

Our counselors help homeowners prevent foreclosure whenever possible, however foreclosure prevention is not always a viable, or even the best, option for the individual. Many times, we find ourselves helping homeowners and renters cope with and recover from the loss of their home. Rhode Island Housing's firm belief – that "home" is much more than four walls and a roof – guides us in ensuring that each person who walks through our doors is offered the best services and options to find a safe, healthy home that they can afford to keep.

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Beyond our assessment and counseling, we negotiate directly with lenders to help with loan modifications whenever possible. We are familiar with the tools, resources and practices available and can advocate on behalf of clients and help streamline the process.

HelpCenter outcome summary for the 1,907 customers who have completed counseling:

- 69 mortgages were brought current
- 689 mortgages where modified, entered into forbearance agreements or received partial claims
- 57 homeowners are actively seeking credit counseling and/or other social services
- 41 mortgages were refinanced
- 114 sought bankruptcy protection
- 164 mortgages were foreclosed and/or deed in lieu of foreclosure
- 68 properties are in the process of a short sale
- 36 properties were sold
- 244 homeowners withdrew from counseling
- 120 homeowners were non-responsive after their first counseling session
- 305 workouts have been denied by servicers and are currently working on other action plans

Currently 808 client files are being reviewed by servicers for workout options and 125 of the modification plans processed through the Home Affordable Modification Program (HAMP) are in a three-month trial period.

The top 10 lenders by volume that the HelpCenter works with on behalf of Rhode Islanders seeking assistance in keeping their home are:

1. Bank of America/Countrywide
2. Chase
3. Wells Fargo
4. CITI
5. American Home
6. Indymac
7. Saxon
8. Litton
9. First Franklin
10. Aurora

Due to high volume, the top three have the slowest response time and greatest delay in communications and response during the workout process. Even if the lending institution's policy states that it wants to help the homeowner, workout plans are taking 60 to 120 days,

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primarily due to the high volume of requests for modifications. This is often too long of a delay to help the homeowner.

Although the Home Affordable Modification Program (HAMP) was introduced in March, we are just beginning to see (HAMP) modification plans come through for homeowners. These plans establish a three-month trial modification plan for homeowners, which creates additional processes and may create new challenges and operational complications.

The lengthy process itself often causes an additional hardship in the already beleaguered homeowner. When appropriate, we provide referrals to reliable resources that offer credit counseling, debt management, help in finding a home to rent, and emergency housing assistance.

More than ever, it is important for homeowners to contact a HUD-approved counseling center like the Rhode Island Housing HelpCenter for assistance as soon as their financial difficulties begin. The sooner they seek assistance and the more involved in the process they remain, the more options there are and the more likely we can reach their desired resolution.

The following are real stories of how our HelpCenter counselors have helped Rhode Islanders.

Homeowner gets fresh start
Situation: A single woman had been struggling to pay her adjustable-rate mortgage and was 10 payments behind since the interest rate and, therefore her payment, had increased. After learning in November that her mortgage company was planning to foreclose, she heard a Rhode Island Housing public service announcement on the radio and came into the HelpCenter.

She had received a loan modification proposal from her lender that offered her a fixed-rate loan – but at a rate of 10.625 percent plus a $5,000 down payment. Although the modification would have held off foreclosure, it also would have increased her already unaffordable payment by nearly $400/month.

Outcome: The HelpCenter counselor worked closely with the homeowner and her lender to negotiate a modification that she could afford while also protecting the lender's investment. Her financial statement demonstrated enough reliable income to satisfy her lender's concerns.

After three months of negotiating, the homeowner's loan was modified to a fixed rate of 7.50 percent for the life of the loan.

The new payment, including taxes and insurance, was $450 less than her old payment. Back taxes and the 10 months of missed payments were added into the loan balance, allowing her to start the new year fresh, with a manageable mortgage and the monthly savings as a cushion

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going forward.

Loss of income causes hardship
Situation: This homeowner had a conservative 6.125 percent fixed-rate mortgage with a payment of $1,981 per month. However, she and her husband were two months behind in their mortgage payments, so she made an appointment at the HelpCenter in October. With her husband unemployed, ineligible for unemployment payments, and her concerns that her overtime would be cut, she was seeking advice. The financial statement revealed a monthly deficit of $650.

Outcome: When first contacted by a HelpCenter counselor, the lender could not offer any work-out options because the request was outside of the lender's work-out policy parameters. The counselor asked if the lender would be willing to modify the rate due to the unemployment hardship.

After submitting a proposal, speaking to a manager, and a two-month processing period, the terms were modified to a 4 percent fixed rate and the term was extended back to the original period of 30 years. The two late payments were capitalized into the loan balance. This reduced her monthly payment by about $300. The HelpCenter counselor also referred the family to a debt-management counselor and to job-assistance services to try to help bridge the gap.

What more can be done?

Despite our tireless efforts and the efforts of our partner agencies that share our mission to ensure access to safe, healthy, affordable homes, there remains much work to be done to recover from our ongoing foreclosure crisis.

1. It is more critical than ever that the government continue to fund housing counseling services that have played a vital role in helping Rhode Islanders keep their homes or find alternative homes that meet their needs and budgets.

2. In addition, we need to seek out new opportunities for providing gap funding for homeowners who can't make their mortgage payments, but need additional support to qualify for a loan modification, as illustrated in the above success stories.

3. As we work to keep Rhode Islanders in their homes, we need access to a wide range of mortgage restructuring options. Providing the flexibility to increase loan terms to 40 years and provide short-term, interest-only payment periods for FHA-insured loans would give us more tools with which to work.

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4. As we continue to focus on ways to recover from this crisis, our ability to work collaboratively and cooperatively with banks, mortgage lenders and servicers in modifying loans in a manner that truly helps the homeowner and addresses the situation, while still protecting the interests of the lenders, is critical. As I mentioned earlier, the current workout process is very arduous and takes months when working with many lenders. In short, it simply does not work in the majority of cases and cannot work for the volume of cases in the pipeline.

One solution to address process delays could be for Congress to implement reasonable modification plan time limits for authorization and assignment to a negotiator and a maximum of 60 days to complete approval of a modification.

Bankruptcy reform could provide the incentive or pressure to expedite workouts and collaborate more effectively, but it should be structured in such a way that it does not penalize responsible lenders who made fair loans that were in the best interest of the customers when the loan was made, and who have worked with their customers compassionately to keep them in their homes.

While some lenders, especially locally-based financial institutions, are working diligently and efficiently with borrowers to modify the loans and keep families in their homes, our HelpCenter's experience with some large, national lending institutions has been far less productive. Significant delays in communication and slow processing times can result in a negative outcome for the homeowner, along with additional hardship and stress for the homeowner and entire family.

We appreciate your commitment to this issue and thank you for giving us this opportunity to share our experiences and expertise gained from our work to ensure that all people who live or work in Rhode Island can afford a safe, healthy home that meets their needs.

As we all know, a good home provides the foundation upon which families can thrive, children can learn and grow, and communities can prosper. It is imperative that we continue to work together to help Rhode Islanders today to ensure a brighter future for Rhode Islanders for generations to come.

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[i] Providence Journal, RI unemployment rate tops 12 percent, June 19, 2009.
[ii] Providence Journal reports, Rhode Island Housing data and estimates, The Warren Group.

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Jeffrey Burlingame Testimony

Good Morning Senator Whitehouse and thank you for the opportunity to be here today. My wife wanted to join us, but she was unable to attend due to work. She works as a freelance technician for a TV station in Boston.

My wife and I bought our home on May 24, 2006 for $319,000. The house was appraised at approximately $350,000. We believe this was around the peak of the real estate bubble.

Since we did not have money for a down payment, we took out two mortgages – a so-called 80/20 arrangement. The 80 percent mortgage carried a 7 percent fixed interest rate for three years. After June 1, 2009, that interest rate could change once per calendar year with a minimum rate of 7 percent and a maximum rate of 13 percent.

The 20 percent mortgage was a 9.25 percent fixed rate, with a balloon payment. This means that the entire remaining balance would be due on June 1, 2036.

According to the City of Woonsocket's tax re-evaluation, our home is worth $247,100. This means we have lost nearly thirty percent of our home's value in three years.

On March 31, 2008, my wife and thirty of her colleagues were given layoff notices from their employer, a Boston TV station. Two months later, she began working as a freelance broadcast technician at another Boston Television station. While we had hoped she might be able to get hired full time somewhere, the television market nationwide has suffered major job losses and cutbacks. This has made her chances of securing a full time job in her field virtually impossible.

Fortunately my career is secure. I'm a firefighter with the City of Woonsocket. I will complete my 12th year of service on February 23, 2010.

On September 25, 2008, my wife and I were able to refinance our 80/20 mortgage with Wells Fargo into one 6 percent fixed rate 30-year mortgage.

In October of 2008, my wife experienced a lack of hours at her freelance job. She was forced to collect unemployment while working only one to two days per week. Our take-home pay dropped by about $300 per week.

On December 11, 2008 we suffered another financial blow. My wife seriously injured her wrist while riding on a shuttle bus. Her only choices were to either live with the pain for the rest of her life, or undergo a partial or possibly full wrist fusion. We decided to go with the surgery, which she had on March 12, 2009.

Due to the nature of her job, my wife was unable to work for two and a half months. During that period we lost close to ten thousand dollars in pay.

On April 17, 2009, we requested a loan modification with Wells Fargo. We hired an attorney to help us through this process. On April 23, 2009 we submitted our financial information and all necessary paperwork.

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Jeffrey Burlingame Testimony

On May 11, 2009 we received a letter from Wells Fargo stating that our account was in review.

One week later my wife logged onto Wells Fargo's website to submit our June mortgage payment as she has done several times prior. She quickly realized that our online privileges were suspended. She called Wells Fargo and stressed to them her concerns about not being notified of the change in our online status. After all, we were still getting email notifications of new statements to view but we were now blocked from viewing them. We were never notified of this change. They didn't send us anything.

Wells Fargo issued a verbal apology and told her to mail the check to them.

Against her better judgment, she sent the payment that day via the US Mail without certification or return receipt. She called Wells Fargo on June 1 and she was told there was no record of her payment and to call the post office.

My wife told them she was going to call every day until she had confirmation that the payment was received. They told her that wasn't necessary and to call at most once a week. They told her that we had until the 15th of June to submit the payment or a late fee would be assessed.

On June 8th we decided to put a stop payment on the check and to pay the bill over the phone. On June 16th Wells Fargo attempted to cash our cancelled check. According to our records we would have been one day late. Fortunately we paid by phone.

For the July and August payments we sent our mortgage check via certified mail. Even though it took several days for Wells Fargo to clear the check, at least we had proof and peace of mind that it was there.

While our account was in review, we received mail correspondence and phone calls from Wells Fargo asking us for more information. We received approximately four phone calls on different days of the week asking us for more information. Each and every time we told the person who was calling us that we had retained a lawyer and all questions and requests for additional information should go through that office. Each and every person said they were unaware we had a lawyer but none of them asked for our lawyer's contact information. They repeated their request for information and when we refused to speak with them they hung up.

On July 4, 2009, our loan modification from Wells Fargo was denied. They cited "this request would be outside of your investor guidelines."

Our lawyer's office told us Wells Fargo said we had an $800 a month deficit in income, which is why we were denied and we didn't qualify for the next step.

On July 14th we resubmitted our request since my wife's hours at work increased.

Since then, our lawyer contacted Wells Fargo and questioned them about how they generated our financial information and the accuracy of it. Our lawyer discovered that they were looking at an old credit report (ignoring our financials worksheet) and said we had a second mortgage and we

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owed almost $2000 a month on car payments. We don't have a second mortgage and our car payments total well under $2000 per month.

As of today our file is still under review.

My wife and I are working hard to retain our home. It seems to us that Wells Fargo would rather foreclose on our house then follow the law and renegotiate our mortgage terms.

In closing, we can only hope that President Obama's "Making Homes Affordable Act" is followed by all lenders as it was intended to be. My wife and I thank you for the opportunity to tell our story here today and urge you to consider bankruptcy reform among other ways to make sure loan companies work to keep people in their homes.

Thank You and God Bless America.

David L. Pollock

Chairman Whitehouse, thank you for inviting me to testify this morning. I am here to present my personal experience attempting to get a loan modification on my home mortgage serviced by Wells Fargo. In 2008, I had a dramatic decline in earned income from real estate commissions as a broker, and the misfortune of owning real estate investments that were underwater. Although I have extensive real estate finance experience, navigating the Wells Fargo process was extremely time-consuming and continuously full of conflicting or incorrect information.

Since 2002, I have been in my own business to purchase, renovate, and sell multi-family real estate in the Providence area and have also worked as a real estate salesperson. In 2005, I purchased two multi-family buildings in Cranston. The mortgages on both buildings are serviced by Wells Fargo and Fannie Mae is the investor. In 2007, I sold my then-residence in Lexington, Massachusetts and moved into a unit in one of the Cranston properties, located on Armington Street.

In December 2008, my Armington Wells Fargo mortgage payment of $3,500 had become un-affordable. With a high 7% interest rate that had been established when the property was non-owner occupied and the property value having declined by 50%, I thought the bank would modify the loan. With excellent credit and current with all debt, I contacted Wells Fargo with the goal of avoiding any bankruptcy. I submitted detailed financial statements with a hardship letter. Wells Fargo arranged a moratorium on the loan with no payments required until May. I had the understanding that at the end of the moratorium my interest rate could be lowered, the loan term could be extended, and possibly be written down to market value.

During those months, I never received a call from Wells Fargo nor had any account executive working with me to determine an acceptable plan. The few times that I did call from February through April, I was told my loan was under review for a modification. Since I did not have any answer at the end of the moratorium, the Loss Mitigation department told me to resubmit all information to start the process again. I called and spoke to Wells Fargo Loss Mitigation representatives who told me that the package had been received and was submitted for review. I was told that I needed to call every week to find out the status.

I called almost twice a week through June and was told EVERY TIME that my application was under review and there was NOTHING more that I could do, but continue to call every week and ask was about the status. It was very frustrating not to know what changes I should make that could change my finances, such as selling a property for a loss or getting a salaried job, and then be able to meet the qualifications for one of the loan modifications.

On June 4, I received a foreclosure letter from Harmon Law offices on my Armington loan. I called both the Harmon office and Wells Fargo. Wells Fargo told me that the foreclosure process will continue while my loan is being reviewed for a modification. I was told that if I paid the outstanding balance owed of over $17,000, they would cancel the foreclosure sale. That was not possible for me since I did not have much cash. I later became aware that all the information I had submitted on May 1 was actually never looked at or entered into the Wells Fargo computer system.

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David L. Pollock

Now, six months after this process began, I had little time to make more dramatic changes to my financial situation. Nobody told me back in January that I needed to meet certain financial criteria for a loan modification.

Since June, I have spent huge amounts of time every couple of days calling Wells Fargo. Every time, I have to speak with a new person and ultimately get different information. I have received conflicting information numerous times. I spoke with people in the Foreclosure, Short-sale, Loss Mitigation, and Customer service departments. In all cases, I could never get one person who was in actually charge of my account. I could only speak with representatives who would make notes and read something from a computer screen.

On July 9, a Supervisor in Loss Mitigation was the first person I ever talked to that seemed helpful. I found out that I had been rejected from the review program a week earlier, even though no one ever called to tell me or to inform me the times I called. I found out that I was rejected because I made too much money; all my rental income was mistakenly counted twice. She once again corrected errors that had been entered into my financial statements and once again requested that I be reviewed for a loan modification. Two hours later, a Negotiator called me for the first time ever. She did not have the information for the loan on my residence, but rather for the loan on my other investment property. She said I didn't qualify for any programs because my income was too high. I once again told her to correct my financial information. They too had counted all my rental income twice. Then she put in a program to pay half of my mortgage payment for 6 months with the goal of a lower interest rate and term extension. I implored her to be in charge of my Armington loan, but the best she could do was to email the Armington negotiator to call me.

Two weeks later, I spoke with another supervisor who needed to correct the income information on my financial statement. I now learned that there were two separate computer systems that did not share information. If you were under review they entered information into one system, and if you were not under current review your information went in another software program.

Three days before the foreclosure scheduled on Friday August 14, the sale was postponed. On Friday morning, Fannie Mae called to tell me that they approved a loan modification based on a 31% debt to income in order to lower my interest rate to 5% with the new payments starting in November. Later when I called Wells Fargo, I was told that a payment agreement was being sent out for me to make my current payment of $3,500/month for three months. After the three months, I would need to submit new financials for a loan modification to be reviewed. The Wells Fargo customer service representative did not know anything about the information that Fannie Mae had told me. Since the Fannie Mae modification was solely based on my income and expenses, I asked Wells Fargo to tell me what was in their system. I could not understand how they had come up with a surplus of almost $650 when a couple weeks before I had a monthly loss of almost $1,000. After I did a detailed review, I discovered that the Wells Fargo numbers did not include any cost for the investment property mortgage payment, which Wells Fargo also services.

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David L. Pollock

At the moment, I do not think the Fannie Mae modification with a decrease in my mortgage payment by $600 is affordable. With an outstanding balance on my Armington loan close to $430,000 and a market value near $200,000, I need to consider all alternatives. If my loan servicer won't agree to write down the loan closer to its market value, I might have to do a short-sale, move out, and the new owner can happily afford to live in my home with only a $200,000 mortgage. Like thousands of homeowners in Rhode Island I continue to be penalized for having bought property at the peak of the housing bubble. Senator, please help us stay in our homes.

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Testimony of John Rao

Attorney,
National Consumer Law Center

Before the United States Senate
Committee on the Judiciary

"Mortgage Modifications During the Foreclosure Crisis:

Is There a Role for Bankruptcy Courts?"

August 20, 2009

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Senator Whitehouse, thank you for holding this hearing and for inviting me to testify today concerning voluntary efforts to modify home mortgages and the potential role of bankruptcy courts in solving our foreclosure crisis. I testify here today on behalf of the low income clients of the National Consumer Law Center (NCLC).[1] NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country. The clients and constituencies of NCLC collectively encompass a broad range of families and households who have been affected by current foreclosure crisis.

In my work as an attorney at NCLC, I provide training and technical assistance to attorneys and housing counselors across the country representing homeowners who are facing foreclosure. Because of my extensive experience in bankruptcy matters, I often speak at educational programs for bankruptcy attorneys, trustees and judges, and I serve as a member of the federal Judicial Conference Advisory Committee on Bankruptcy

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[1] The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (2d ed. 2007), as well as bimonthly newsletters on a range of topics related to consumer credit and bankruptcy issues. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. This testimony was written with the assistance of Alys Cohen, Staff Attorney, and Diane E. Thompson, Of Counsel, NCLC.

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Rules. My testimony is based on this work and over twenty-five years experience representing consumers in debt collection, bankruptcy and foreclosure defense matters, initially as an attorney with Rhode Island Legal Services and head of its Consumer Unit. I continue to assist attorneys at Rhode Island Legal Services with bankruptcy and foreclosure cases.

While federal bankruptcy law generally permits claims of secured creditors to be modified in bankruptcy cases, it currently singles out home mortgage claims and shields them from modification, other than through a plan which cures a mortgage default. This provision in the Bankruptcy Code prevents homeowners from changing the interest rate, amortization, or term of mortgage loans in a Chapter 13 case, the type of bankruptcy consumers often file to save a home from foreclosure. Over the past two years, Congress has considered legislation that would repeal this provision and allow modification of home-secured loans in Chapter 13 cases. This change in the law would greatly assist homeowners and would complement the Department of Treasury's loan modification program outside of bankruptcy.

Foreclosures Still Outpacing Voluntary Loan Modifications

We are now three years into the foreclosure crisis and unfortunately there have been no signs of improvement. The statistics are grim. New foreclosure filings have continued to increase since 2007, with approximately 290,000 reported in March 2009. Realtytrac recently reported that an additional 300,000 homes go into foreclosure every

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month.[2] For 2008, foreclosure filings nationwide were up 81 percent over 2007 filings.[3] At the end of the first quarter of 2009, 3.85 percent of residential mortgage loans were in foreclosure, which accounts for more than 2 million homes.[4] As of March 31, 2009, the Mortgage Bankers Association reported that 7.24 percent of residential mortgage loans were seriously delinquent. For subprime mortgage loans, an incredible 24.88 percent were reported as seriously delinquent. In addition, 9.12 percent of all loans outstanding as of the end of the first quarter of 2009 were in delinquent status. This delinquency rate is the highest in the MBA's records going back to 1972.[5] In fact, all of these statistics are record breaking and suggest that we are facing the greatest foreclosure crisis since the Great Depression.

Projections for the future are likewise bleak. Goldman Sachs estimates that, starting at the end of the last quarter of 2008 through 2014, 13 million foreclosures will

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[2] Realtytrac, 1.9 Million Foreclosure Filings Reported On More Than 1.5 Million U.S. Properties in First Half of 2009, *available at* http://www.realtytrac.com/ContentManagement/PressRelease.aspx?channelid=9&ItemID=6802.

[3] RealtyTrac, Inc., Foreclosure Activity Increases 81 Percent in 2008 (Jan. 15, 2009), *available at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=5681&accnt=64847.

[4] Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009) (reporting that 3.85% of 44,979,733, or 1.7 million, mortgages serviced were in foreclosure). Roughly half of these were serviced by national banks or federal thrifts. *See* Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 8 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf (reporting that 884,389 foreclosures were in process by national banks and federal thrifts at the end of the first quarter of 2009). The estimate of more than 2 million homes in foreclosure is achieved by extrapolating from the MBA numbers. The MBA survey only covers approximately 80% of the mortgage market. Thus, (44979733*3.85%)/0.8=2.16 million.

[5] See MBA Press Release, Delinquencies and Foreclosures Continue to Climb in Latest MBA National Delinquency Survey, May 28, 2009.

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be started.[6] The Center for Responsible Lending, based on industry data, predicts 2.4 million foreclosures in 2009, and a total of 9 million foreclosures between 2009 and 2012.[7] Recent reports also indicate that a new wave of foreclosures will take place affecting Alt-A mortgages. These are mortgages that were generally given to borrowers with higher credit scores than subprime borrowers, but were made with non-traditional underwriting standards. One rating agency, Standard and Poor's, last month downgraded the ratings for mortgage-backed securities of Alt-A mortgages made between 2005-2007, based on higher unemployment and the continuing problems in the housing market.

Among the potential solutions to this crisis, loan modifications have been identified as one of the preferred strategies.[8] In fact, because many of the loans in or soon to be in foreclosure were made without considering the homeowner's ability to pay or were underwritten using inflated property appraisals, any plan to address the current crisis that does not include some form of loan modification as an essential component will fail. While the potential benefits of loan modifications are clear, the response from the financial services industry has been lacking and is dwarfed by the magnitude of the foreclosure problem.

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[6] Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), at 16; *see also* Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* 1 (Dec. 4, 2008) (predicting 9 million foreclosures for the period 2009-2012).

[7] Center for Responsible Lending, Soaring Spillover 1 (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

[8] *See, e.g.,* Sheila C. Bair, Chairwoman, Federal Deposit Insurance Corp. (FDIC), Remarks to the American Securitization Form (ASF) Annual Meeting (June 6, 2007) ("The immediate task is to sustain homeownership by ensuring the servicers have the flexibility they need to make prudent loan modifications.").

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Since the start of the current foreclosure crisis, there have been several efforts to encourage loan modifications through voluntary measures. Several were implemented before the Home Affordable Modification Program (HAMP), announced by President Obama's administration on March 4, 2009. In September 2007, federal and state banking regulators issued a joint statement on loss mitigation strategies, referencing earlier guidance and encouraging use of loss mitigation authority available under pooling and servicing agreements.[9] In October 2007, as part of the HOPE NOW program, former Treasury Secretary Paulson sought voluntary commitments from servicers to contact borrowers and explore new loan modification approaches.[10] Then in December 2007, Secretary Paulson announced a plan for "fast track" loan modifications.[11]

Despite industry claims to the contrary, these initial programs failed as a loan modification strategy to stop the foreclosure crisis. The HOPE NOW program's first data issued in early 2008 demonstrated that little progress had been made.[12] The Mortgage Bankers Association's report on loan modifications issued in January 2008 revealed similar results. The major finding was that, in the third-quarter of 2007, mortgage servicers worked out 183,000 repayment plans and 54,000 loan modifications, while

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[9] Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages (Sept. 2007), *available at* http://www.occ.treas.gov/ftp/bulletin/2007-38a.pdf.
[10] Associated Press, Paulson to Mortgage Industry: Help Curb Defaults (Oct. 31, 2007), *available at* http://money.cnn.com/2007/10/31/real_estate/paulson_housing.ap/.
[11] Press Release, Statement of Treasury Secretary Henry M. Paulson, Jr. at Press Conference to Announce Framework to Help Preserve Communities by Preventing Foreclosure (Dec. 6, 2007), *available at* http://www.treas.gov/press/releases/hp716.htm.
[12] *See* HOPE NOW: Results in Helping Homeowners (Feb. 2008) (data covers eighteen servicers representing two-thirds of the industry), *available at* http://www.fsround.org/hope_now/pdfs/JanuaryDataFS.pdf; *see also* HOPE NOW, Alliance Servicers, Prime and Subprime Residential Mortgages: 2007 Loss Mitigation Activities (Feb. 2008), *available at* http://www.fsround.org/media/pdfs/NationaldataFeb.pdf.

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starting 384,000 new foreclosures.[13] Both reports confirmed that servicers relied heavily during this period on repayment plans rather than loan modifications. Repayment plans require homeowners to make increased monthly payments to cure arrears. They do not address payment affordability problems caused by high interest rates and rate resets on adjustable rate mortgages.

A recent paper in the Boston Federal Reserve Bank's Public Policy series found that less than eight percent of all the loans 60 days or more delinquent were modified during 2007-2008.[14] Professor Alan White, in examining pools of securitized mortgages, found that the number of modifications varied dramatically by servicer, ranging from servicers who modified as many as 35 percent of the loans in foreclosure to as few as 0.28 percent of the loans in foreclosure in November 2008.[15] Even at the high end of 35 percent of all mortgages in foreclosure, the modification rate is not enough to reduce the foreclosure rate to pre-crisis levels.[16]

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[13] Jay Brinkmann, Mortgage Bankers Association, An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and other Loss Mitigation Activities in the Third Quarter of 2007 (Jan. 2008), *available at* http://www.mortgagebankers.org/files/News/InternalResource/59454_LoanModificationsSurvey.pdf.

[14] Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 35 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

[15] Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Modification Contracts,* Conn. L. Rev. 12-13 (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1325534.

[16] *See* Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12 (noting that the number of foreclosures has more than doubled from pre-crisis levels).

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Worse, the modifications offered pre-HAMP (and presumably still by servicers not offering HAMP modifications) were overwhelmingly ones that increased the borrower's payment and principal balance. Only about three percent of the delinquent loans studied in Boston Federal Reserve Bank paper received modifications that reduced the payment.[17] Professor White's data shows that, in the aggregate, modifications increase the principal balance.[18] While the first quarter 2009 data from the OCC and OTS show that a majority of the modifications (excluding short term payment plans or forbearance agreements) decreased the payment, virtually all of those modifications also increased the principal balance by capitalizing arrears.[19] Unsurprisingly, redefault rates on loan modifications remain high.[20]

HAMP has attempted to overcome problems with earlier administration programs and the long standing reluctance by servicers to perform large numbers of sustainable loan modifications. HAMP seeks to change the dynamic that leads servicers to refuse even loan modifications that would be in the investors' best interests by providing both servicers and investors with payments to support successful loan modifications. Several

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[17] Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

[18] Alan White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports,* Fordham Urb. L. J. 20 (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259538#

[19] Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 5 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf.

[20] Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 6 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf.

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months into the Home Affordable Modification Program (HAMP), however, homeowners and their advocates report that the program is not providing a sufficient number of loan modifications to homeowners, the modifications offered often do not meet the guidelines of the program, and the program itself still presents serious barriers to mass loan modifications. Moreover, even if HAMP operated at its full capacity as envisioned by Treasury officials, HAMP's loan modifications still would be substantially outpaced by foreclosures, and the modifications themselves lack the mandated principal reductions that we believe are necessary to stem the foreclosure tide.

To date, implementation of HAMP by servicers has been slow and sporadic. The Administration's recent efforts to hold servicers accountable[21] are a welcome and necessary step forward, however, further changes to the program's design are needed for the program to reach even its stated goals. On August 4, 2009, the Administration released its first report on HAMP progress.[22] During the period from May to July, 2009, it was reported that approximately 230,000 trial modifications had begun. While this may appear to be a good start, it is actually less total modifications than had been made by the industry in the period just before HAMP. For the first quarter of 2009, the mortgage industry reported that 360,000 modifications had been made.[23] Of more significant concern is that several large servicers, such as Bank of America, Wells Fargo,

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[21] Renae Merle, *White House Prods Banks: Letter Tells Chiefs To Start Backing Mortgage Relief,* Wash. Post, July 10, 2009, a*vailable at* http://www.washingtonpost.com/wp-dyn/content/article/2009/07/09/AR2009070902928.html?nav=rss_business.

[22] United States Department of the Treasury, *Making Home Affordable Progress Report,* May 14, 2009, *available at* http://www.treas.gov/press/releases/docs/05142009ProgressReport.pdf.

[23] *See* HOPE NOW Mortgage Loss Mitigation Statistics, available at http://www.hopenow.com/industry-data/HOPE%20NOW%20National%20Data%20July07%20to%20Jun09%20.pdf.

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Ocwen and Wachovia, have failed to extend modifications to a significant portion of homeowners estimated to be eligible for HAMP. According to Treasury figures, while these four servicers have a total of 1,243,920 eligible homeowners, they started trial modifications for only 2 percent to 6 percent of this total (4% for Bank of America, 6% for Wells Fargo, 5% for Ocwen and 2% for Wachovia). One servicer, National City Bank, had extended HAMP modifications to **0 percent** of its estimated 37,126 eligible homeowners. And these figures even underestimate the lack of progress because they are based only on homeowners who are 60-plus days delinquent. These figures do not consider the much larger group that would include homeowners who are eligible based on being in imminent default.

The Treasury report also noted that based on the initial figures, it has been projected that HAMP will modify 3 to 4 million mortgages over the next three years. Assistant Treasury Secretary Herbert Allison, in responding to questioning from the Senate Banking Committee, agreed that in order to meet Treasury's goals, the program would need to do 1 million per year—approximately 20,000 per week.[24] Even if the Administration reaches those numbers, that will address no more than one-third of all foreclosures.[25] This leaves a majority of all foreclosures still unaddressed.

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[24] *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (Senator Schumer's question of Assistant Treasury Secretary Herbert Allison).

[25] If we compare the Center for Responsible Lending's predictions of 9 million foreclosures for the period 2009-2012, Center for Responsible Lending, Soaring Spillover 1 (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf., with Treasury's prediction that HAMP will provide 3-4 million modifications over the same period, and then recognize that not every modified loan would have resulted in a foreclosure absent modification, one-third seems a generous estimate for the amount of reduction in the foreclosure rate afforded by HAMP.

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Another reason why HAMP should not be the sole loan modification program for responding to the foreclosure crisis is that a large number of homeowners are apparently not eligible for HAMP or are being steered by servicers to less helpful non-HAMP loan modifications. While this may reflect servicer disincentives and administrative problems discussed below, it has the potential to significantly reduce the Administration's projections of homeowners that will be helped by HAMP. For example, just before the first HAMP report was issued, Chase released figures on June 30, 2009 showing that since the servicer started processing HAMP modifications on April 6, 2009, it had approved 87,100 HAMP trial modifications and another 50,900 non-HAMP trial modifications to borrowers Chase said were not eligible for HAMP. It is of grave concern that 37 percent of Chase's loan modifications were not HAMP modifications because the borrowers were claimed to be ineligible for HAMP. Chase failed to report the number of homeowners who were not approved for any modifications during the period, nor did they disclose the terms on the non-HAMP loan modifications.

Moreover, the lack of mandated principal reductions under HAMP raises questions about the long-term sustainability of the modifications. Absent a mandate of principal reduction, almost all borrowers are likely denied the possibility of principal reductions, which undermines the long-term success of their modifications, and thus their homeownership. The double-whammy of declining home values and job losses helps fuel the current foreclosure crisis.[26] Homeowners who could normally refinance their way out of a lost job or sell their home in the face of foreclosure are denied both options

[26] *Preserving Homeownership: Progress Needed to Prevent Foreclosures*: *Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009), at 4-5 (testimony of Paul Willen).

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when they owe more on their home than it is worth. Without principal reductions, homeowners who lose their jobs, have a death in the family, or otherwise experience a drop in income are more likely to experience redefault and foreclosure.[27] The threat of high rates of redefault looms without a meaningful way to reduce the principal balance of mortgages.

HAMP Design and Implementation Problems

Creating affordable and sustainable loan modifications for distressed homeowners on a loan-by-loan basis is labor intensive.[28] In fact, HAMP has imposed data collection and documentation requirements that in many cases exceed that which was done when many of the troubled loans were originated. Under many current pooling and servicing agreements, additional labor costs incurred by servicers engaged in this process are not compensated by the loan owner. While HAMP does provide servicer compensation for successful modifications, it is too early to determine whether servicers will view that as fair compensation for the additional administrative burdens. By contrast, servicers' costs in pursuing a foreclosure are compensated.

Under this cost and incentive structure, it is no surprise that servicers continue to push homeowners into less labor-intensive repayment plans, non-HAMP loan modifications, or foreclosure. Even though HAMP has now been in operation for four months, attorneys and housing counselors continue to report to NCLC that homeowners

[27] This is especially so since the HAMP modification program does not permit a second HAMP modification for any reason, even if there is a subsequent, unavoidable drop in income.
[28] Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 7(Oct. 3, 2007), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470.

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they are working with are being offered less helpful non-HAMP loan modifications. In most cases, they are not told whether they were processed for a HAMP modification, or if they were, the reasons why they were denied a HAMP modification. The HAMP program does not require servicers to give homeowners this essential information. Whether or not homeowners who are offered non-HAMP modifications were in fact eligible for HAMP is uncertain.

Homeowners have encountered numerous bureaucratic barriers in attempting to obtain HAMP modifications. Homeowners' loan files are routinely lost.[29] Housing counselors report waits of months to hear back on review for a trial modification. A recent story in the Providence Journal reported that a Rhode Island homeowner mailed 99 pages of financial documentation to her servicer and four months later, still had not been notified that her modification had been approved. In another case, Select Portfolio Services advised counsel for a New York borrower on three separate occasions over six weeks that the necessary broker price opinion had been cancelled due to "system errors" and a new request would have to be submitted.

One of the key benefits to having a national loan modification program is that it can provide uniformity and standardization to the loan modification process. To some extent, HAMP has achieved that goal by providing eligibility guidelines and standard form agreements. Curiously, though, Treasury chose not to standardize the application process. HAMP does not require the use of a uniform loan modification application form and checklists for homeowners to provide the required information and documentation. That makes it particularly difficult for housing counselors to assist homeowners since

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[29] Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures,* N.Y. Times, June 28, 2009.

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each servicer has different forms. To make matters worse, homeowners are expected to return required documents within days of receipt. Homeowners in both New York and Florida have reported receiving the trial modification agreements the same day the servicer required their return. One Illinois homeowner received her trial modification agreement three days after she was required to return the agreement.

More seriously, homeowners have no leverage to obtain a HAMP loan modification from even a participating servicer. It is unclear if the Administration's compliance efforts will be able to detect and remedy servicer noncompliance. Servicers are not even required to stop foreclosure proceedings while they are processing a homeowner for HAMP; they are merely encouraged to do so. This exacerbates the problem by adding thousands of dollars in additional foreclosure and attorney costs that ultimately are borne by the homeowner and capitalized into a higher loan principal amount. It also creates confusion for homeowners and discourages them from completing the arduous application process and trial period. Moreover, homeowners have no clear remedies if they are improperly denied a HAMP modification, assuming they can even figure out that the denial was improper due to the lack of transparency of the Net Present Value test and the lack of denial notices.

What is lacking in the system is not a carrot; what is lacking is a stick.[30] Servicers must be required to make modifications, where appropriate, and the penalties for failing

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[30] *See Helping Families Save Their Homes: The Role of Bankruptcy Law: Hearing Before the S. Comm. on the Judiciary,* 110th Cong., 2nd Sess. (Nov. 19, 2008), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?renderforprint=1&id=3598&wit_id=4083 (statement of Russ Feingold, Member, Sen. Comm. on the Judiciary) ("One thing that I think is not well understood is that because of the complex structure of these

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to do so must be certain and substantial. The leverage missing from HAMP is directly addressed by other proposals, including judicial modifications of distressed mortgages.

Specific Limitations under Current Bankruptcy Law

When homeowners facing foreclosure have been unable to obtain a loan modification or other loss mitigation option from their mortgage holders, they have often turned to Chapter 13 bankruptcy as a last resort for saving their homes. One of the most significant provisions in Chapter 13 has been the right to cure defaults on loans, even if the lender has called the loan due before the bankruptcy is filed and even if such right to cure does not exist under state law or the consumer's loan contract. Bankruptcy law currently permits homeowners to cure defaults within a reasonable time by making payments on the arrears together with the ongoing payments during the plan.

The cure right in Chapter 13 has long served an important role for the same reason that court-ordered loan modifications are now needed. Because of the limitations of voluntary workout options, some mortgage servicers even before the current foreclosure crisis were not permitted by investors of mortgage loans to approve repayment or forbearance plans longer than six to twelve months, which is too short a period for many borrowers to affordably cure a default. Other servicers were simply too aggressive in pursuing foreclosure without offering workout options or were the cause of the homeowner's foreclosure problem because of negligent servicing.[31] Chapter 13

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securitized mortgages that are at the root of the financial calamity the nation finds itself in, voluntary programs to readjust mortgages may simply be doomed to failure.").

[31] *See* Kurt Eggert, Limiting Abuse and Opportunism by Mortgage Servicers, 15 Housing Policy Debate 753, 756–58 (2004).

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therefore made long-term repayment plans available when mortgage lenders and their servicers had not been willing to negotiate reasonable similar plans.

However, the cure provisions in current law work best when homeowners have had a temporary loss of income (unemployment, illness, divorce, natural disaster, and so forth) which caused the default, and they now have sufficient income at the time the Chapter 13 case is filed to pay during the plan the arrears which have accumulated and the regular monthly payment. For this model to be successful, it goes without saying that the mortgage loan must have been affordable for the homeowner when the loan was made. Likewise the homeowner must be able to prospectively afford the regular monthly payments, taking into consideration any changes in terms permitted under the loan documents that would affect the monthly payment, during the three to five years of the plan.

The right to cure a mortgage default in a Chapter 13 bankruptcy has several significant limitations. Taken alone, this provision does not permit the homeowner to change the amount and timing of installment payments, the interest rate, and other similar terms of the mortgage. It also does not give the homeowner the right to reduce the mortgage creditor's lien to the value of the collateral as compared with the outstanding balance owed on the secured debt.

Other provisions of the Bankruptcy Code do however provide the right to "modify" secured claims to debtors in Chapter 11, 12 and 13 cases.[32] This ability to modify secured claims is possible for virtually every type of debt except for the mortgage

[32] *See* 11 U.S.C. §§ 1123(b)(5), 1222(b)(2), 1322(b)(2).

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on the borrower's primary residence.[33] This well-entrenched principle of bankruptcy law generally permitting modification of secured claims and the exception for home mortgages in Chapter 13 cases can be summarized as follows:

> **Bifurcation and Modification.** In determining the allowed amount of a creditor's secured claim, section 506(a) of the Code provides that the claim is secured only to the extent of the value of the collateral and that any amount of the claim in excess of the collateral will be treated as an unsecured claim. This "bifurcation" or "cram down" of the creditor's claim means that the unsecured portion of the claim will be paid with other unsecured claims the debtor may have, based on the plan's treatment of unsecured claims. In addition to this claim bifurcation, section 1322(b)(2) permits the plan to modify the rights of holders of secured claims, such as by extending the payment term or adjusting the interest rate and installment payment amount under the underlying contract.
>
> **Cram Down Limitation.** Although section 1322(b)(2) generally authorizes the modification of allowed secured claims in a Chapter 13 plan, an exception preventing modification is provided for those claims secured "*only by a security interest in real property that is the debtor's principal residence.*" While four Circuit Courts had found that this language in the 1978 Bankruptcy Code did not prevent a cram down of a mortgage lender's lien when considered with section 506(a),[34] the Supreme Court in *Nobleman v. American Savings Bank*, 113 S.Ct. 2106 (1993) held that modification of home mortgage lender's rights, including the cram down of its lien, is impermissible.

While there is scant legislative history directly addressing the anti-modification clause in section 1322(b)(2),[35] it may have been intended to promote the flow of capital into the residential mortgage market at a time when such lending was experiencing pressures from record-high interest rates. Congress enacted other laws at approximately

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[33] Chapter 12 "family farmers" are permitted to modify home mortgages.

[34] *In re* Bellamy, 962 F.2d 176 (2d Cir. 1992); *In re* Hart, 923 F.2d 1410 (10th Cir. 1991); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990); *In re* Hougland, 886 F.2d 1182 (9th Cir. 1989).

[35] *See* Grubbs v. Houston First American Savings Assn., 730 F.2d 236 (5th Cir. 1984).

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the same time, for example, to assist lenders in making market-rate loans despite state usury caps.[36]

However, efforts to expand the availability of credit at that time were soon replaced by serious concerns about the explosive growth in the residential mortgage lending and abusive lending practices. In 1994, Congress passed the Home Ownership and Equity Protection Act (HOEPA) to prevent some predatory lending practices after reviewing compelling testimony and evidence presented during a number of hearings that occurred in 1993 and 1994. This law created a special class of regulated closed-end loans made at high rates or with excessive costs and fees.[37] It was hoped that HOEPA would reverse the trend of the prior decade, which had made abusive home equity lending a growth industry and contributed to the loss of equity and homes for many Americans.

Unfortunately, as is apparent from the current foreclosure crisis, HOEPA and limited regulatory efforts did not stop abusive lending practices. Indeed, the problem grew worse. Bankruptcy attorneys, legal services offices, housing counselors, and attorneys who assist homeowners in foreclosure now routinely see clients with mortgages that were unaffordable when made and whose terms are so oppressive that traditional tools for dealing with foreclosures such as workout agreements and Chapter 13 cure plans are no longer effective.

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[36] Depository Institution Deregulation and Monetary Control Act ("DIDMCA"), 12 Pub. L. No. 960221, 94 Stat. 161 (1980), and the Alternative Mortgage Transaction Parity Act ("AMTPA") (1982), 12 U.S.C. §3801. The legislative history for these laws suggests that Congress was concerned about the solvency of the savings and loan industry, as well as concerns about the general viability of consumer lending. *See* Cathy L. Mansfield, The Road to Subprime "Hel" was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market, 51 S.C.L. Rev. 473, 495 (2000).
[37] 15 U.S.C. § 1602(AA)(1)(B).

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Bankruptcy courts are currently powerless to defer or change payment terms that would be a modification of the mortgage not permitted under section 1322(b)(2).

Voluntary to Mandatory: Court-ordered Mortgage Modification

To help families save their homes from foreclosure, Congress has considered legislation that would amend the Bankruptcy Code to give bankruptcy courts the same authority to modify home mortgage loans as they have for virtually every other kind of secured and unsecured debt. This legislation addresses the limitations in current Chapter 13 based by making the following key changes:

> **Repeal Special Protection for Home Mortgages in Section 1322.** This change would permit some borrowers who were provided unaffordable loans to lower their monthly payment to an amount they can pay and to keep that payment amount permanent by converting their ARM to a fixed rate mortgage. It will help borrowers blunt the devastating effect of future rate adjustments which were often not properly considered by lenders when assessing ability to repay at the time the loans were made. For high LTV loans made based on the lender's careless underwriting decisions and inflated or fraudulent appraisals, and borrowers with negative equity due to depreciating home values, borrowers who file Chapter 13 to deal with a foreclosure would have the right to reduce the mortgage claim to the value of the property. This change will extend to low- and middle-income consumers the same protections that are afforded family farmers, corporations, and wealthy individuals who own investment properties.
>
> **Amend Section 1322 to Permit Reamortization.** Permitting modification by itself does not fully address the problem based on the current structure of the Bankruptcy Code. This is because modified secured claims in Chapter 13 must be paid in full during the three to five years of the plan. For home mortgages with large outstanding balances, this is impossible for most borrowers and they would not benefit from the change permitting modification. The solution to this is one which Congress has already provided for family farmers in Chapter 12 cases. Chapter 13 should be amended to include a provision similar to Bankruptcy Code section 1222(b)(9) which permits the borrower's loan to be reamoritized based on the modified terms and paid over a period beyond the plan term, generally up to thirty years.

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These changes would allow homeowners in foreclosure to repay their mortgages on fair and reasonable terms that fully protect the mortgage holder. Like any secured creditor, the mortgage holder would be entitled to adequate protection of its property interest during the Chapter 13 case. Mortgage holders will receive at least as much as they would realize if the property were foreclosed, even if there is a cram down based on the property's value. For lenders who make high LTV or no equity loans based on risky underwriting practices, they can hardly expect a different outcome since they did not take a security interest in the consumer's home based on its true economic value.[38]

Suggestions that these changes will deter investment in mortgage-backed securities or drive up costs to homeowners are unfounded. Simply put, the number of residential mortgages that would realistically be subject to cram down is so insignificant in comparison to the total mortgages made that such an impact is highly unlikely. In fact, these changes could cause fewer Chapter 13s to be filed as more homeowners can be expected to obtain voluntary modifications outside bankruptcy. But even if current filings remain constant or even modestly increase, the number of potential Chapter 13 filings will be small in comparison to the overall mortgage market. Given the difficulties of living under a strict court-supervised plan in which all of disposable income must be dedicated for a three to five year period, only homeowners who have no other option for

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[38] This was clearly recognized by the Office of Thrift Supervision in its 1998 announcement to lenders:

> When the combined LTV exceeds 90 percent, however, the proceeds from the sale of the security property will likely not be sufficient to fully liquidate the home equity loan and any outstanding senior liens. The portion of such loans that exceeds 100% of value is effectively unsecured, ... High LTV lenders state that they recognize that these loans are more or less unsecured, and it is not likely they will benefit from foreclosure.

Thrift Bulletin TB 72, Office of Thrift Supervision, Department of the Treasury, August 27, 1998, at 1.

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dealing with foreclosure can reasonably be expected to seek a loan modification in Chapter 13. And consumers in Chapter 13 cases do not receive the benefit of any cram down of secured debts until they have completed their plans at the end of a three- to five-year period. Congress has also considered reasonable limitations on cramdown, such as a "clawback" provision, that would limit any impact on future mortgage rates.

Advantages of the Bankruptcy Option

It is clear that some form of enforcement mechanism is needed to encourage servicers to modify home mortgages. Unlike other enforcement tools that Treasury or Congress might consider which would be subject to legal challenges and costly government administrative costs, bankruptcy court-ordered modifications have already been tested to withstand constitutional and administrative challenges. A court system is already in place that would oversee modifications without the use of taxpayer dollars. It would also provide homeowners with the legal right to a modification even if the servicer claims that the securitization documents prevent it from modifying the loan.

A recent report by Deutsche Bank suggests that the problem of "negative equity" is growing worse.[39] At present, the report notes that approximately 14 million, or 27 percent of all homeowners, owe more on their mortgages than their houses are worth. Significantly, they estimate that 25 million, or 48 percent of all homeowners, will have negative equity before home prices stabilize as projected in 2011.

[39] *See* Deutsche Bank Securitization Report, *Drowning in Debt - A Look at "Underwater" Homeowners*, Aug. 5, 2009.

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Loan modifications with principal reductions appear to have the lowest redefault rates.[40] In areas will high cost mortgage markets, HAMP modifications may simply not be possible without principal reduction based on the "waterfall" for reaching payment affordability. HAMP's use of principal forbearance instead of principal reduction results in large balloon payment obligations that prevent future refinancing and continue the stigma of negative equity. Thus, HAMP's greatest weakness in ensuring sustainable modifications may be its failure to mandate principal reductions. The first quarter 2009 data from the OCC and OTS shows that virtually all of the modifications on GSE and private investor securitized loans did not involve any principal reduction.[41] Loans that were not securitized and held by banks in portfolio were more likely to have principal reduction, but still only accounted for 5.9% of portfolio loan modifications. The stark reality is that absent a mandate of principal reduction or a bankruptcy modification option, virtually all borrowers will be denied the possibility of principal reductions. The availability of a cram down in Chapter 13 will encourage servicers and mortgage holders to consider principal reduction when making HAMP modifications. It was the experience of family farmers that when Chapter 12 was enacted, more voluntary modifications involving principal reduction were negotiated.

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[40] *See, e.g.,* Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, *Loan Modifications and Redefault Risk: An Examination of Short-Term Impact* (Center for Community Capital, March 2009), *available at* http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf.

[41] Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 5 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf.

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Incorporating a loan modification right in Chapter 13 will provide needed assistance to families who for one of many possible reasons have not been able to obtain HAMP or other loan modifications. It will also provide an incentive for many lenders and servicers to work with homeowners and their representatives early in the foreclosure process and to make good on their claims that loss mitigation options are available. In my experience, consumers are never eager to file Chapter 13, so a change that encourages the availability of reasonable modifications will help many homeowners actually avoid filing Chapter 13 bankruptcy.

Another major impediment to loan modifications has been the existence of secondary mortgage loans. Treasury estimates that up to 50 percent of at-risk mortgages have second liens.[42] Many servicers are reluctant to modify a first mortgage if the second mortgage holder does not consent or subordinate its mortgage, and second mortgage holders have not been willing to cooperate. HAMP attempts to address this problem through its Second Lien Program which provides two alternatives for second lien holders - accept a modification of the loan (reduction of interest rate to one to two percent) or receive a small payment in exchange for release of the lien (ranging from 3 to 12 cents per dollar of unpaid principal). It is unclear whether second mortgage holders will find either of these options acceptable. Once again, bankruptcy court modifications address this problem because all of the liens on the property can be addressed at the same time based on a uniform set of laws and valuation standards.

Finally, another problem not addressed by HAMP is that many homeowners are burdened with debt other than their home mortgages. Unable to refinance their homes,

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[42] *See* Dept. of Treasury Making Home Affordable Program Update, April 29, 2009.

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many homeowners are struggling to pay off credit card and other non-mortgage debt. This problem is made more acute by the current unemployment situation, with many homeowners experiencing a loss or reduction in family income. While HAMP requires borrowers whose total monthly debt ratio ("back-end ratio") is 55 percent or greater to obtain credit counseling, there is no plan to directly assist homeowners in dealing with unmanageable debt. A bankruptcy option in which all of the family's financial problems can be dealt with under the supervision of a court approved plan would greatly assist homeowners who would otherwise likely redefault on a HAMP mortgage modification.

Conclusion

Thank you for the opportunity to testify today. A timeline should be set to evaluate whether HAMP, along with other existing programs, can sufficiently address the foreclosure crisis. Unless HAMP both increases its reach and mandates principal reductions, Congress should pass legislation to allow bankruptcy judges to modify home loans in bankruptcy. Adoption of court-supervised mortage loan modifications would sidestep many of the structural barriers in the servicing industry that today are preventing mass loan modifications from occurring. Congress soon should recognize that voluntary measures, even with incentives, by entities that profit from homeowner default can not lead us out of this crisis.

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Testimony of Joseph Verdelotti, Jr.

Chairman Whitehouse, thank you for the opportunity to testify here today. This is the second time this summer that you have invited me to tell my story before the Senate Judiciary Committee and I am grateful for your attention to my case.

My name is Joe Verdelotti Jr. and I'm a licensed electrician from West Warwick, Rhode Island. My wife April works at the Roger Williams Medical Center in Providence, RI. We have been married for 9 ½ years, and have known each other for nearly 20 years. We have one daughter, Brooke who is 9, and two sons, Lorenzo who is 6, and Gianni who just celebrated his 1st birthday a few months ago. Needless to say we have quite an active household. On January 26, 2006, we purchased a 1,100 square-foot home in West Warwick, Rhode Island for $225,000.

Since we, like many other homeowners, did not have savings for a down payment, we took out two mortgages. The first mortgage, which covered 80% of the purchase price, is an Adjustable Rate Mortgage that is currently at 6.5%, but will adjust in the fifth year. The second mortgage, which covered the other 20% of the purchase price, has a fixed interest rate of 9.25%. Both mortgages were originally through Aurora Loan Services, but CitiMortgage subsequently purchased the second mortgage.

At the time we purchased our home, I was a fourth-year electrician's apprentice making $18.00 an hour. The construction industry was booming and times were good in Rhode Island. The good times did not last, however. Not long after we purchased our home, the recession began and work became scarce.

My company has had to lay off workers and make cut-backs just to stay afloat. As of today, we still have a wage freeze in effect, and our health care premiums have increased. In addition, we just learned that we will lose the Columbus Day holiday and will not be paid for days at the end of December unless we use our vacation time. My wife too has felt the effects of the recession at work and is also under a pay freeze. Despite our income freeze, the cost of living has not slowed and we are feeling the squeeze. Our utility bills, such as electric and water, have increased, as have our property taxes – and we may see further increases in the future. Our budget is stretched as tight as we can get it.

Like many of our neighbors, our home is "underwater." It just isn't worth what we paid for it at the height of the housing bubble in 2006. We received a glimmer of hope last fall when the Help for Homeowners program took effect, but that proved to be a disappointment. The day the program started, my wife called the number listed on HUD's website and spent hours waiting and talking to someone at debt service about our situation. In the end, their only advice to her was to consider a roommate, get a part time job, contact the United Way to locate food banks in our area, reduce spending, and contact legal aid for a consultation with a bankruptcy attorney. The person on the phone even recommended we consider walking away and letting the bank foreclose.

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We called for help in saving our home and were told to consider food banks and foreclosure.

I later contacted Aurora Loan Service directly and spoke with a customer service agent to see if they would be willing to work with us under the Help for Homeowners program. After giving the necessary information to the agent over the phone, I was met with another disappointing blow: the agent informed me that I did not make enough money for them to help us and that we should consider a short sale.

Next, we decided to apply for a financial hardship package through CitiMortgage. On February 26, 2009 we sent CitiMortgage the necessary documents through certified mail. The documents were received on March 2. On March 20, my wife contacted CitiMortgage at approximately 1pm to try and find out to the status of our hardship application, but all she got was the run around. Each person she spoke to said she had the wrong department and that they would transfer her to the right one, but this never happened. This went on until I came home from work and I took over. Each person was clearly reading the same talking points: we always had the wrong department and they would transfer us to the correct department. After listening to elevator music on hold for over an hour, I too gave up. We had been on the phone with CitiMortgage for over five hours and accomplished nothing!

On April 8, 2009, my wife contacted CitiMortgage again and, after several attempts to get a straight answer, she was informed that our case was closed since they never received our packet. She informed them that it was sent on February 26 and that we had delivery confirmation that they received it on March 2. After hearing this, they changed their story to "It must have gotten lost" and that we would need to resubmit the application. This was quite unsettling to hear because that package contained all of our personal and financial information.

Since we have two mortgages we also sent a hardship package to our 1st lien holder, Aurora Loan Service. In a letter dated March 11, 2009, just 2 days after receiving the package, Aurora denied our request.

In May, I once again requested a mortgage modification from CitiMortgage. This time we were rejected because, according to them, we make sufficient income to support our current mortgage payment. They also suggested that we consider a short sale. CitiMortgage apparently believes that we make enough to cover our mortgage, but that we should consider a short sale… This seems pretty contradictory to me.

Now, even though we are current on our financial obligations, we are hardly living comfortably. We have had to make even more adjustments in order to make ends meet, and it gets increasingly difficult. We are not sure how much longer we can survive like this. My health care premiums rose at the same time the Make Work Pay tax credit took effect so I now take home $2.00 less a week than I used to. How can my family and others help stimulate the economy if Congress doesn't do something fast to help curb this foreclosure problem?

Testimony of Joseph Verdelotti, Jr.

All we are asking for is a little help, a little consideration, and a little professionalism on the part of our mortgage holders. If we're able to negotiate a more manageable payment plan and keep our home, it becomes a win-win solution for everyone: we keep our home, the banks avoid the costs of foreclosure, and the community avoids a hit to property values and tax collections.

Senator, please do something to help struggling homeowners like my wife and I. Thank you again for the opportunity to tell my story.

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